

RECEIVED

NOV 23 1998

**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

DECLARATION OF JOHN B. HAYES

MARKET POWER AND THE BELL ATLANTIC- GTE MERGER

**The Tilden Group, LLC.
23 November 1998**

TABLE OF CONTENTS

I. INTRODUCTION AND QUALIFICATIONS.....	1
II. OVERVIEW.....	2
III. BELL ATLANTIC AND GTE POSSESS <i>DE FACTO</i> MONOPOLIES IN LOCAL EXCHANGE AND ACCESS MARKETS.....	4
A. METHODOLOGY FOR ASSESSING MARKET POWER	4
B. BELL ATLANTIC AND GTE DOMINATE THEIR LOCAL EXCHANGE AND ACCESS MARKETS.....	4
<i>i. Switched Access Lines.....</i>	<i>7</i>
<i>ii. Minutes of Use.....</i>	<i>9</i>
<i>iii. Local Exchange Facilities.....</i>	<i>13</i>
C. THE COMPETITIVE LANDSCAPE FOR BUSINESS AND RESIDENTIAL CUSTOMERS	16
<i>i. Residential and Small Business Customers Lack Competitive Alternatives.....</i>	<i>16</i>
D. ENTRY IS UNLIKELY TO DIMINISH BOC MARKET POWER OR ELIMINATE THE NEED FOR ON-GOING REGULATION IN THE NEAR FUTURE.....	19
<i>i. Local Telephone Markets are Not Yet Open to Competition.....</i>	<i>19</i>
<i>ii. CLECs Will Continue to Rely Upon ILEC Cooperation to Interconnect with ILEC Networks.....</i>	<i>21</i>
E. THE PROPOSED OUT-OF-REGION ENTRY STRATEGY WILL NOT EXPAND THE COMPETITIVE ALTERNATIVES AVAILABLE TO RESIDENTIAL CUSTOMERS IN THE NEAR FUTURE	22
IV. CONCLUSION.....	24
APPENDIX A: CURRICULUM VITA FOR DR. JOHN B. HAYES	A-1
APPENDIX B: RELEVANT MARKETS FOR PUBLIC INTEREST ANALYSIS.....	B-1
APPENDIX C: DATA SOURCES FOR TABLE 5.....	C-1

I. INTRODUCTION AND QUALIFICATIONS

1. My name is John B. Hayes. I am a Senior Economist employed by The Tilden Group, a consulting firm that applies economic analysis to issues of antitrust and regulatory policy. My work as an economist has been in the area of microeconomics, with a specialization in the study of antitrust and regulatory policies. In the course of my professional career I have had numerous opportunities to consider questions of market definition in the context of mergers and acquisitions generally.
2. I was previously employed by the U. S. Department of Justice for five years. Most recently, I assisted in the Department's evaluations of the Ameritech and SBC applications to provide in-region long-distance services. I have also taught courses at Georgetown University and advised government officials in the United States and other countries on antitrust and telecommunications policy.
3. I earned a Ph.D. in Economics from the University of Wisconsin, where my major field of study was Industrial Organization. A copy of my curriculum vitae is attached to this declaration as Appendix A.
4. I have been asked by counsel for Sprint to determine the markets relevant to an analysis of the competitive effects arising from the proposed merger of Bell Atlantic and GTE; to identify the participants, together with their shares, in those markets; and to assess the competitive significance of these market participants. In reaching my conclusions I have relied upon the Bell Atlantic-GTE *Merger Application*¹ and affidavits offered in this proceeding, evidence submitted in state

¹ *Application For Transfer of Control*, , CC Docket. No. 98-184, filed October 2, 1998 ("Merger Application").

and federal section 271 proceedings, industry reports, previous Tilden Group analyses of telecommunications markets, and the relevant economic literature. Drawing on my training and experience as an economist, and my review of the relevant facts available to me, I find that the proposed merger raises significant public interest concerns.

II. OVERVIEW

5. I previously filed a declaration with the Federal Communications Commission ("the Commission") describing the markets relevant to an analysis of the SBC-Ameritech merger, a matter that currently is pending before the Commission. The economic issues relevant to properly defined markets that were identified and evaluated in my prior declaration are in all significant respects unchanged in the current application. Because of these similarities, I have attached the relevant section from my prior declaration as Appendix B and will rely generally on the conclusions with respect to market definition described therein.² Specifically, the product markets relevant to an analysis of the competitive effects of the proposed merger are local exchange and access markets, and the geographic markets relevant to an analysis of the merger are the local service areas of Bell Atlantic and GTE. In addition, there are three customer segments with distinct demand characteristics: large business customers, medium-sized business customers, and small business and residential customers. The demand characteristics of these segments are sufficiently different that the competitive effects of the proposed merger should be separately studied in each of these segments.

² Appendix B was previously filed with the Commission on 14 October 1998 as section III of the Declaration of John B. Hayes, "Market Power and the SBC-Ameritech Merger."

6. In this declaration, I provide evidence on market shares in local exchange and access markets in the regions served by Bell Atlantic and GTE and assess the competitive significance of market participants in those service areas. My review of the evidence leads to the following principal results and conclusions:

- While the market share data are incomplete, there is persuasive evidence that local exchange and access markets are highly concentrated for all customer segments and in virtually all geographic markets. Large business customers located in major metropolitan areas are more likely than others to have viable competitive alternatives for service, but even for these large customers choices are limited. Small business and residential customers, with few exceptions, have no alternative service providers available. Aggregating across customer segments and geographic markets, the market share served by competitors to Bell Atlantic and GTE never exceeds two percent in any state, and in most states the CLEC share is less than one percent.
- Bell Atlantic and GTE possess substantial market power in many local exchange and access markets, and they will continue to possess market power for years to come. Further, competitors and providers of complementary services, such as long distance and mobile wireless services, will continue to require cooperation from the incumbent, both for existing services and for new and innovative forms of telecommunications.
- The out-of-region entry strategy proposed by Bell Atlantic and GTE is unlikely to benefit residential and small business customers in the near term. The proposed entry initially targets large and medium-sized business customers where competition is already developing.
- The merger of Bell Atlantic and GTE does not meet the Commission's public interest standard that the merger will enhance competition.³

³ *In the Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, Memorandum Opinion and Order, FCC 97-286, released August 14, 1997 ("Bell Atlantic-Nynex Order") at ¶¶2-3.

7. In the remainder of this declaration, I explain in detail the economic logic, factual analyses, and supporting data that have led me to the findings summarized above.

III. BELL ATLANTIC AND GTE POSSESS *DE FACTO* MONOPOLIES IN LOCAL EXCHANGE AND ACCESS MARKETS

A. Methodology for Assessing Market Power

8. The courts have long recognized that market share is an important predictor of an ability to exercise market power. In addition to market share, however, one must also consider other measures of structural characteristics of the relevant markets, indicators of market performance, and entry conditions.

B. Bell Atlantic and GTE Dominate Their Local Exchange and Access Markets

9. While the data available to assess market structure in the relevant markets are limited, they provide persuasive evidence that Bell Atlantic and GTE have dominant shares of local exchange and access markets in each customer segment.⁴

⁴ See also *Petition of Bell Atlantic-Pennsylvania, Inc. For a Determination of Whether the Provision of Business Telecommunications Services Is Competitive Under Chapter 30 of the Public Utility Code*, “Recommended Decision,” Docket No. P-00971307, July 24, 1998 (“*Bell Atlantic-Pennsylvania Business Services Petition*”) at 4-5 (“...I conclude that BA-PA has not come close to establishing...that there is effective competition for business services throughout BA-PA’s service territory such that BA-PA would be unable to sustain price increases for its services. BA-PA’s presentation on the issue of competitive presence does not withstand even the most cursory review.”), and *In the Matter of the Board’s Investigation Regarding the Status of Local Exchange Competition*, “Report and Action Plan,” Docket No. TX98010010, July 1998 (“*Status of Local Exchange Competition*”) at 1-2 (“...the Board finds that there has not been any significant statewide ‘resale based’ or ‘facilities based’ local land line residential or small business telephone offerings to or switching of customers to CLECs from ILECs in New Jersey or the nation.”).

Moreover, because CLECs must interconnect with the incumbent carrier, their ability to discipline efforts to exercise market power is to a considerable extent controlled by the incumbent. As there are no viable substitutes for local exchange and access services, Bell Atlantic and GTE could substantially raise prices or degrade the service they provide to competitors, unless they are prevented from doing so by regulation.

10. That the ILECs possess substantial market power is hardly news. The Commission previously has found this to be true on numerous occasions.⁵ Both the Commission and state regulators cap access charges for precisely this reason.⁶ Moreover, the interconnection and structural separation provisions of the Telecommunications Act of 1996⁷ also are based on recognition of ILEC market power.⁸ In this declaration, I provide some evidence on the extent of the market power possessed by Bell Atlantic and GTE. Several alternative measures of market structure are examined, including:

⁵ See, for example, *In the Matter of Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, Notice of Proposed Rulemaking, CC Docket No. 95-185, released January 11, 1996 (“*LEC-CMRS Interconnection Proceeding*”) at ¶2 (“ILECs unquestionably still possess substantial market power in the provision of local telecommunications services.”).

⁶ See *In the Matter of Access Charge Reform*, First Report and Order, released May 16, 1997 at ¶¶258-284.

⁷ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996). The 1996 Act amends the Communications Act of 1934, 47 U.S.C. §§ 151 et. seq.

⁸ See *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, Notice of Proposed Rulemaking, CC Docket No. 96-149, released July 18, 1996 at ¶3 and *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Notice of Proposed Rulemaking, CC Docket No. 96-98, released April 19, 1996 at ¶¶6-10.

- shares of switched access lines;
- shares of switched minutes of use; and
- the existence of local service facilities, including collocation facilities and fiber facilities.

11. My analysis concentrates on switched facilities because switched lines provide both local exchange and access services. Shares of switched lines are therefore a useful indicator of market structure in both local exchange and access markets.⁹ As the Commission has observed, “[B]ecause interstate switched access is generally provided over the same ‘bottleneck’ facilities and by the same providers as provide local exchange and exchange access service, failure to create competition among local service providers necessarily means a lack of competition to provide interstate switched access.”¹⁰

12. The publicly available data are limited in several respects. Most importantly, the data are not available by customer segment or local service area. My conclusions are therefore based on an examination of state-level data reported separately for business and residential customers.

⁹ Shares of switched access lines may not provide a useful measure of market structure for exchange access services provided to certain high-volume customers. Some high-volume customers, such as large businesses, can purchase dedicated, special access lines. There is evidence that CLECs have a greater share of special access lines than switched access lines. This is the case both because CLECs have been selling special access longer than switched access, and more importantly, because special access lines are installed at locations that have sufficient traffic volumes to support profitably multiple high-capacity access lines. Consequently, customers who purchase special access are precisely the customers that are most readily served by CLECs. Special access lines account for 16 percent of total access lines and 19 percent of total interstate access revenues. *1997 Preliminary SOCC*, Tables 2.5 and 2.9.

¹⁰ *Bell Atlantic-Nynex Order* at ¶31.

i. *Switched Access Lines*

13. Table 1 reports market shares of switched access lines within the Bell Atlantic states. Bell Atlantic's share of switched access lines ranges from 98 percent in Massachusetts and New York to 100 percent in West Virginia. Aggregating across all in-region states, Bell Atlantic's market share is nearly 99 percent.

TABLE 1. BELL ATLANTIC MARKET SHARE OF LOCAL EXCHANGE LINES

<i>Bell Atlantic Market Share</i>			
State	Business	Residential	Combined
DC	99.41%	99.84%	99.25%
DE	99.66%	98.93%	98.59%
MA	98.26%	99.74%	98.00%
MD	99.79%	99.85%	99.64%
ME	99.74%	99.99%	99.73%
NH	98.91%	99.96%	98.86%
NJ	99.83%	99.74%	99.56%
NY	98.42%	99.59%	98.01%
PA	99.18%	99.37%	98.55%
RI	99.29%	99.86%	99.16%
VA	99.78%	99.92%	99.70%
VT	99.77%	100.00%	99.77%
WV	100.00%	100.00%	100.00%
Bell Atlantic Market Share (weighted by lines in service)	99.11%	99.67%	98.78%

Source: Second Local Competition Survey.

14. Table 2 reports market shares of switched access lines within the GTE local service regions. GTE's share of switched access lines exceeds 99 percent in all of its regions except Florida, where its market share is 98.73 percent. In 12 of the 15

states reported in Table 2, GTE serves virtually all of the switched lines in its local service area.¹¹

TABLE 2. GTE MARKET SHARE OF LOCAL EXCHANGE LINES

<i>GTE Market Share</i>			
State	Business	Residential	Combined
CA	99.93%	99.17%	99.09%
FL	99.47%	99.26%	98.73%
HI	99.99%	99.99%	99.98%
IL	100.00%	100.00%	100.00%
IN	100.00%	100.00%	100.00%
KY	99.80%	99.98%	99.78%
MI	100.00%	100.00%	100.00%
NC	99.85%	99.98%	99.84%
OH	100.00%	100.00%	100.00%
OR	99.99%	99.99%	99.97%
PA	99.99%	100.00%	99.99%
TX	99.53%	99.36%	98.89%
VA	99.99%	99.99%	99.98%
WA	99.99%	99.99%	99.98%
WI	99.94%	100.00%	99.94%
GTE Market Share (weighted by lines in service)	99.84%	99.60%	99.44%

Source: *Second Local Competition Survey*.

15. The market share estimates reported in Tables 1 and 2 are based on data from the *Second Local Competition Survey*.¹² The figures include CLEC customers served through resale and UNE loops in the CLEC share. These are two of the three methods that CLECs use to provide service. The publicly

¹¹ GTE reported data for 15 of its 28 states in the *Second Local Competition Survey*.

¹² *Second CCB Survey on the State of Local Competition*, available at www.fcc.gov (data as of June 30, 1998) ("*Second Local Competition Survey*").

available data from the *Second Local Competition Survey* do not include information on customers served over facilities owned by CLECs, the third method that CLECs use to provide service. Tables 1 and 2 therefore do not include CLEC on-net customers. Because there are few CLEC on-net customers in most states, including them in the calculations would reduce the ILEC share by an insignificant amount.¹³

ii. *Minutes of Use*

16. There are publicly available data for the states directly affected by the merger from which to estimate the share of switched local service minutes carried by CLECs operating in BOC service areas.¹⁴ Table 3 and 4 contain market shares of switched local service minutes for the Bell Atlantic and GTE states.¹⁵ Table 3

¹³ For example, Bell Atlantic's combined share of residential and business customers, including CLEC on-net customers, in Delaware and Virginia are: Delaware - 98.52 percent, as compared to the 98.59 percent reported in Table 1; Virginia - 99.47 percent, as compared to 99.70 percent reported in Table 1.

¹⁴ By definition, the CLEC share of minutes is equal to the number of minutes that originate or terminate on CLEC networks divided by the total number of minutes that originate or terminate in the ILEC service area. I have estimated the CLEC share by dividing the number of minutes CLECs exchange with the ILEC by the total number of minutes that originate or terminate on the ILEC's network. This estimate necessarily understates actual CLEC shares of total local exchange and access minutes of use because it does not include, in either the numerator or the denominator, minutes for calls that travel entirely on CLEC networks. As these calls are unquestionably a tiny fraction of the total, this source of bias is small. For example, if customers have balanced calling patterns, *i.e.*, customers make the same number of incoming and outgoing calls, and CLECs have a 5 percent share of customers, then the estimation method that I use would exclude one quarter of one percent (5 percent squared) of the total number of calls.

¹⁵ The data are from the *First CCB Survey on the State of Local Competition*, available at www.fcc.gov (data as of December 31, 1997) ("*First Local Competition Survey*"). The *First Local Competition Survey* data includes local, intrastate and interstate switched minutes. As the BOCs are prohibited from carrying interLATA minutes, the latter two categories are largely switched access minutes.

shows that Bell Atlantic's share of switched minutes ranges from 97.3 percent, in New York, to 100 percent, in New Hampshire. Bell Atlantic's share of switched minutes, averaged across its entire service region, is 98.7%. Table 4 shows that GTE's share of switched minutes ranges from 96.9 percent in Florida to 100 percent in several states.¹⁶ GTE's share of switched minutes, averaged across its entire service region, is 98.7%.

TABLE 3. BELL ATLANTIC MARKET SHARE OF NETWORK MINUTES OF USE

State	Bell Atlantic Minutes	Minutes Exchanged with CLECs	Distribution of Interconnection Minutes		Bell Atlantic Market Share
			Originating On ILEC	Terminating on ILEC	
DC	3,914,094,573	72,654,342	88.9%	11.1%	98.18%
DE	2,844,179,229	N/A	N/A	N/A	N/A
MD	20,664,044,746	193,764,052	94.4%	5.6%	99.07%
NH	3,701,159,999	0	0.0%	0.0%	100.00%
NJ	30,055,911,001	75,548,950	89.4%	10.6%	99.73%
NY	58,044,431,350	1,437,357,889	89.2%	10.8%	97.30%
PA	32,864,097,911	603,349,556	91.5%	8.5%	98.20%
RI	3,354,495,953	N/A	N/A	N/A	N/A
VA	20,255,539,401	10,800,806	93.9%	6.1%	99.93%
VT	1,596,841,523	N/A	N/A	N/A	N/A
Bell Atlantic Market Share (weighted by minutes)					98.67%

Source: First Local Competition Survey.

¹⁶ GTE reported identical numbers of minutes exchanged with CLECs in Missouri and North Carolina. Because one or both of these data points is likely an error, I did not report the data for these two states.

TABLE 4. GTE MARKET SHARE OF NETWORK MINUTES OF USE

State	GTE Minutes	Minutes Exchanged with CLECs	Distribution of Interconnection Minutes		GTE Market Share
			Originating On ILEC	Terminating on ILEC	
AL	410,721,150	0	0.0%	0.0%	100.00%
AZ	9,732,311	0	0.0%	0.0%	100.00%
AR	311,361,901	0	0.0%	0.0%	100.00%
CA	12,124,276,432	276,759,025	98.3%	1.7%	97.77%
FL	3,178,304,137	101,636,823	87.6%	12.4%	96.90%
HI	590,631,897	116,974	37.3%	62.7%	99.98%
IA	397,812,411	0	0.0%	0.0%	100.00%
ID	175,582,015	0	0.0%	0.0%	100.00%
IL	3,244,329,489	0	0.0%	0.0%	100.00%
IN	1,235,723,135	0	0.0%	0.0%	100.00%
KY	646,109,698	0	0.0%	0.0%	100.00%
MI	1,653,842,334	4,369,134	100.0%	0.0%	99.74%
MN	163,867,338	0	0.0%	0.0%	100.00%
MO	586,132,786	N/A	0.0%	100.0%	N/A
NC	607,862,367	N/A	0.0%	100.0%	N/A
NE	74,446,748	0	0.0%	0.0%	100.00%
NM	145,055,551	0	0.0%	0.0%	100.00%
NV	50,421,448	0	0.0%	0.0%	100.00%
OH	1,215,088,961	0	0.0%	0.0%	100.00%
OK	134,538,990	0	0.0%	0.0%	100.00%
PA	1,102,851,966	0	0.0%	0.0%	100.00%
SC	329,222,945	0	0.0%	0.0%	100.00%
TX	2,162,994,022	1,469,545	0.0%	100.0%	99.93%
VA	1,115,095,097	0	0.0%	0.0%	100.00%
WA	1,148,567,463	49,178,907	73.0%	27.0%	95.89%
WI	1,011,203,479	0	0.0%	0.0%	100.00%
GTE Market Share (weighted by minutes)					98.70%

Source: First Local Competition Survey.

17. Tables 3 and 4 also contain data on the distribution of minutes exchanged over trunks connecting CLEC and BOC networks. Inspection of these interconnection data reveals that the minutes exchanged across BOC and CLEC networks are notably unbalanced.¹⁷ Tables 3 and 4 show that CLECs originate far

¹⁷ Hawaii stands out as an exception to this pattern.

fewer minutes to BOC networks than they terminate from the incumbent's network. If CLEC customers were equally likely to originate and terminate calls, these distribution data would show equal percentages of minutes originating and terminating on the ILEC's network. The unbalanced distribution data in Table 5 suggest that CLECs have been most successful at selling service to customers, such as Internet service providers, that terminate far more calls than they originate.¹⁸

18. The unbalanced origination and termination minutes exchanged between ILEC and CLEC networks suggest that CLEC sales are concentrated in a limited market segment, an inference that provides a reason to be cautious about predicting CLEC success in a broader local service market. Additional analysis is needed to understand why CLECs have been especially successful in this market segment. Specifically, it is unclear whether the competitive advantages that CLECs possess in this segment are sustainable over time and will prove valuable in the broader market.

19. For example, CLEC success with Internet service providers may be partly explained by reciprocal transport and termination rates that are in excess of cost. If these rates are set above cost, then CLECs have an incentive to seek customers that terminate more calls than they originate. CLECs could offer such customers unusually attractive service rates because, net of reciprocal compensation payments to the BOC, they earn rents on call termination services sold to the ILEC. This type of competitive advantage would not extend to customers with

¹⁸ Bell Atlantic recently argued that Internet service providers operating on CLEC networks are driving the traffic imbalance. Letter from Edward D. Young, III, Senior Vice President and Deputy General Counsel, and Thomas J. Tauke, Senior Vice President for Government Relations, on behalf of Bell Atlantic, to William E. Kennard, Chairman, Federal Communications Commission, dated July 1, 1998.

balanced calling patterns because these customers would not provide transport and termination rents to the CLEC. Moreover, this type of advantage is not sustainable because it is not based on an inherent cost or other advantage possessed by CLECs.¹⁹

iii. *Local Exchange Facilities*

20. Because it is doubtful that resale will create sufficient competitive pressure to significantly discipline BOC market power, it is useful to separately assess the shares of CLECs that are providing facilities-based local service. While offering valuable competition over some aspects of service, such as marketing, billing, and customer service, resale is of inherently limited competitive significance and is therefore less meaningful as a constraint upon the exercise of market power than facilities-based service.²⁰ Facilities-based CLECs can offer additional competition along a number of dimensions, such as service innovation and network quality, where the capabilities of resellers are limited. Because resale rates are not based on the underlying costs of the facilities, resale competition can do relatively little

¹⁹ It is ironic that the BOCs are now working to limit their transport and termination payments to CLECs, after they opposed Bill and Keep arrangements in the CMRS interconnection proceeding. *LEC-CMRS Interconnection Proceeding* at 38. Wireless carriers tend to originate more calls than they terminate. Thus interconnection with wireless carriers at transport and termination rates set above cost would tend to generate net rents for the BOCs.

²⁰ See *Bell Atlantic-Pennsylvania Business Services Petition* at 21-24 (“A [resale] ‘competitor’ is unable to differentiate its offering from BA-PA’s on quality, is unable to introduce innovative services, and cannot assert price pressure on BA-PA, since BA-PA dominates the reseller’s cost structure.” [citation omitted]) and *Status of Local Exchange Competition* at 7 (“Although the ‘resale strategy permits CLECs to enter the market quickly, this strategy suffers from certain constraints in pricing and innovation for CLECs.”).

to drive retail rates down towards cost.²¹ Facilities-based competitors also represent alternative sources of access services, while resellers do not serve this function.

21. Facilities-based competition also is superior to resale competition because it represents far greater competitor independence of the ILEC. For the purposes of competitive assessment, a key issue is whether one firm is dependent upon its *competitors* for key inputs. Clearly, CLECs who are reselling BOC service remain heavily dependent upon the BOC to provide service, contractual and regulatory protections notwithstanding. In its merger analyses, the U.S. Department of Justice routinely recognizes in merger analysis that firms dependent upon rivals for key inputs (*e.g.*, through a supply agreement designed to fix an anticompetitive outcome associated with an acquisition) typically are not as strong a competitive force as those that operate independently. Competition from firms that rely upon a rival for a key input, and whose basic ability to offer services is dependent upon contractual rights unwillingly imposed on a direct rival, are generally not “economically equivalent” to fully independent rivals. Of course, all CLECs, including facilities-based CLECs, are dependent on ILECs for interconnection services.

22. Looking only at facilities-based service, the data show that CLECs serve a tiny fraction of total switched access lines.²² Table 5 details the CLEC share of

²¹ Harris and Teece, in an affidavit on behalf of Ameritech Michigan, appear to agree with this, stating that “for purposes of competitive assessment, self-supplied facilities and leased unbundled network elements...are clearly distinct from resale of services over the incumbent’s facilities.” *Harris-Teece Michigan Affidavit* at 15.

²² The New Jersey Board of Public Utilities has collected data on CLEC facilities nationwide. They report that CLECs provide facilities-based service to approximately 2,500 of the 108 million local residential lines (or significantly less than 1/10 of 1 percent)

facilities-based lines to business and residential customers in a number of Bell Atlantic states where there are sufficient publicly available data to calculate market shares of facilities-based lines. These data include access lines purchased as unbundled loops from the BOC and facilities owned by CLECs. Resold lines are counted as part of the Bell Atlantic share. Bell Atlantic's share of facilities-based service to business customers ranges from about 98 percent in Pennsylvania to nearly 100 percent in the District of Columbia. In comparison, facilities-based service to residential customers is *de minimus*. The CLEC share of facilities-based service to residential customers does not exceed one-half of one percent for any of the states shown in Table 5.

TABLE 5. CLEC FACILITIES-BASED MARKET SHARE OF LINES

<i>JLEC Facilities-Based Market Share</i>			
State	Residential	Business	Combined
DC	99.98%	99.95%	99.96%
DE	99.89%	99.77%	99.84%
MD	99.92%	99.66%	99.82%
NJ	99.93%	99.82%	99.89%
PA	99.88%	98.05%	99.22%
VA	99.84%	99.56%	99.74%
Market Share (weighted by total lines)	99.90%	99.25%	99.65%

Source: See Appendix C.

and to approximately 400,000 of the 52 million local business lines (or approximately 7/10 of 1 percent). See *Status of Local Exchange Competition* at 10.

C. The Competitive Landscape for Business and Residential Customers

23. Residential customers are far less likely to have competitive alternatives to Bell Atlantic and GTE than are business customers.²³ In large part, this reflects the relative attractiveness to CLECs of the various market segments. Bernie Ebberts, WorldCom's Chairman and CEO, has stated that "Not AT&T, not MFS or anyone else, is going to build local telephone facilities to residential customers. Nobody ever will in my opinion."²⁴ The evidence on CLEC business plans and facilities locations examined in this section confirms that while competition for business customers is developing, there are limited prospects for competition to provide local service to residential customers. In a subsequent section I evaluate the likely impact of the out-of-region entry strategy announced by Bell Atlantic and GTE on competitive conditions in local exchange and access markets.

i. Residential and Small Business Customers Lack Competitive Alternatives

24. The announced business plans and actual marketing efforts of CLECs indicate that most entrants into local exchange and access services markets principally are interested in attracting business, as opposed to residential, customers.²⁵ CLEC strategies largely concentrate on service to high-volume business customers located in major urban centers. My analysis of the evidence shows that, consistent with national trends, CLEC facilities in Bell Atlantic and

²³ See *Status of Local Exchange Competition* at 14 ("To date, virtually no land line 'facilities based competition' in the residential market has occurred in Pennsylvania and New York...").

²⁴ Mike Mills, "Hanging Up on Competition?," *Washington Post*, June 1, 1997 at H1.

²⁵ See *Status of Local Exchange Competition* at 5 ("The Board finds that a vast majority of the CLECs that are pursuing the land line facilities based entry strategy have only targeted business customers, at this time.").

GTE service areas generally are concentrated in major urban areas. With few exceptions, most CLECs have no plans to offer residential service in the near term.²⁶

25. At the present time, there is only a limited potential for profitable entry into the residential and small business segment of local exchange and access markets. The major long-distance companies have scaled back or frozen their initially-ambitious plans to enter local markets, citing poor profitability.²⁷ Sprint, MCI, and AT&T, for example, have each testified that competitive entry through resale into the State of New Jersey's local service markets would not provide a reasonable return on their investment, and Bell Atlantic's own expert testified that CLECs would lose \$3 per customer per month reselling Bell Atlantic-New Jersey's

²⁶ See "CLEC Officials, Wall Street Predict Continued Growth, But Not in Local Residential Market," *Communications Today*, November 4, 1997. Brooks Fiber/Worldcom has entered the residential local exchange and access services market on a facilities basis in Michigan, but it has not expanded its residential service outside that state. *Communications Today*, *op. cit.* See also *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, Memorandum Opinion and Order, FCC 97-298, released August 19, 1997 ("Ameritech Michigan Order") at ¶65. It is too early to tell whether WorldCom will continue to pursue this strategy.

²⁷ In January of this year, MCI President Timothy Price announced that "as long as the current regulatory environment continues, MCI will not offer resale service to any new residential customers." See January 22, 1998 MCI Press release, available at <http://www.mci.com>. This was soon followed by an announcement from AT&T's chairman Michael Armstrong that "the company has halted its efforts on the total services resale (TSR) method of local service entry but will continue to support its current local customers.... TSR discounts are not big enough to make it an economically viable way for AT&T to provide local service." See AT&T Press release, January 26, 1998, available at <http://www.att.com>. AT&T claims to be losing \$3 a month per local telephone customer. "AT&T Says It Loses Money on Local Telephone Service," *St. Louis Post-Dispatch*, February 11, 1998. AT&T apparently is still working on its wireless local service plans.

service.²⁸ GTE evidently agrees with this assessment of the prospects for resale, as it has “concluded that a resale strategy alone cannot succeed.”²⁹ Cable companies have also pulled back on their highly-touted plans,³⁰ although a few cable companies, such as Cox, Cablevision and MediaOne, have recently begun offering telephony services over cable plant to limited numbers of customers.³¹ It is too early to tell whether the proposed AT&T-TCI merger will reinvigorate efforts to offer telephony over cable TV plant.³² Dan Miller, chairman of the Illinois Commerce Commission, explains the current limited competition for residential customers by observing: “What nitwit is going to go in and start competing where the prices don’t cover the cost?”³³

26. Mobile wireless service also is not currently a practical economic alternative to wireline local exchange and access service for the vast majority of customers. Mobile wireless service generally is not priced competitively with

²⁸ *In the Matter of the Board’s Investigation Regarding the Status of Local Exchange Competition*, “Comments of the Division of the Ratepayer Advocate,” Docket No. TX98010010, May 1, 1998 (available at www.njin.net/rpa/pos-pape.htm).

²⁹ Declaration of Jeffrey C. Kissell (“Kissell Declaration”) at 3.

³⁰ TCI, for example, dropped its cable telephony plans. See Mark Robichaux, “Bad Call: Malone Says TCI Push into Phones, Internet Isn’t Working for Now,” *Wall Street Journal*, January 2, 1997 at A1. Time Warner also suspended its cable telephony plans. See Stephan Somogyi, “Sages or Stooges?,” *Upside*, June 1997 9(6) at 62-68.

³¹ See *En Banc Presentation on the Status of Local Telephone Competition*, “Testimony of Alex Netchvolodoff,” January 29, 1998 (available at www.fcc.gov); and Carl Weinschenk, “Double Your Money—Or at Least Give It Your Best Shot,” *Tele.com*, November 1, 1998 (available at www.teledotcom.com).

³² See Leslie Cauley, “TCI, AT&T Look to Enter Partnerships With Cable-TV Firms on Phone Service,” *Wall Street Journal*, September 24, 1998 at B14.

³³ As quoted by Jerri Stroud in “Competition is Key to Phone Deal’s Approval,” *St. Louis Post-Dispatch*, May 17, 1998.

basic wireline service for a consumer with a high volume of calling from a fixed site to nearby end users.³⁴ To date, mobile wireless service has been further limited in its ability to substitute for basic telephone service by its relatively low data transmission rates, lower voice quality, and the fact that wireless customers pay for both incoming and outgoing calls. I am optimistic that wireless service will eventually compete with wireline service for a significant number of local exchange customers. The steadily decreasing prices, rapid network build-outs, and increasing penetration rates all speak to that possibility. But the fact remains that wireless service does not provide meaningful competition to wireline local exchange and access services at this time.

D. Entry is Unlikely to Diminish BOC Market Power or Eliminate the Need for On-Going Regulation in the Near Future

i. Local Telephone Markets are Not Yet Open to Competition

27. Despite their claims to the contrary, Bell Atlantic and GTE have not yet sufficiently opened their local telephone markets to competition. State authorities in Michigan, New York, New Jersey and Pennsylvania each have found that Bell Atlantic and GTE have not met their obligations under the Telecommunications Act to open their local service markets to competition.

- The Michigan Public Service Commission (“MPSC”) ruled that GTE’s “conduct to date does not give the Commission reason to believe that the company will permit competition...”.³⁵ The MPSC went on to note that it

³⁴ See *In the Matter of Second Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, Declaration of Carl Shapiro and John Hayes on Behalf of Sprint, CC Docket No. 98-121, filed August 4, 1998.

³⁵ *In the Matter of the Application of GTE Communications Corporation for the Issuance of a License to Provide and Resell Basic Local Exchange Service in Ameritech*

issued final orders requiring GTE to act on its interconnection agreements with AT&T and Sprint in December 1996 and that GTE has failed to comply with those orders.³⁶

- The New Jersey Board of Public Utilities issued a report finding that there are “two major barriers to local land line telephone competition in New Jersey....the most significant barrier to competition is the lack of standardized Operations Support Systems.... The Board finds the second ‘major barrier’ to competition is access to ‘unbundled network elements’.”³⁷
- An administrative law judge in New York ruled that “This record indicates unequivocally that Bell Atlantic-New York’s options alone...are unacceptable to support combination of elements to serve residential and business customers on any scale that could be considered mass market entry. Given this record, at this time, absent the provision of the element platform pursuant to the Pre-filing, Bell Atlantic-New York would be in compliance neither with 251(c)(3) nor, consequently, 271(c)(2)(B)(ii).”³⁸
- An administrative law judge in Pennsylvania ruled that “The credible evidence of record demonstrates that the collocation constraints described here have, in fact, acted to inhibit the growth of facilities based competition in BA-PA’s service territory.”³⁹ (emphasis in original)

28. It is significant that state commissions have found that Bell Atlantic does not currently satisfy the section 271 standard. Section 271 does not require that BOCs face effective competition before interLATA authority is granted. It instead requires only that local service markets be opened to competition. Successful 271

Michigan’s and GTE North Incorporated’s Exchanges in the State of Michigan and Related Approvals, “Opinion and Order,” Case No. U-11440, December 12, 1997 at 4.

³⁶

Id.

³⁷

Status of Local Exchange Competition at 11, 15.

³⁸

Proceeding on Motion of the Commission to Examine Methods by which Competitive Local Exchange Carriers Can Obtain and Combine Unbundled Network Elements, Case 98-C-0690, “Proposed Findings of Administrative Law Judge Eleanor Stein,” released August 4, 1998.

³⁹

Bell Atlantic-Pennsylvania Business Services Petition at 36.

applicants can, and they almost certainly will, retain substantial market power in local exchange and access markets even when interLATA authority is granted. These state commission rulings show that local exchange and access markets in Bell Atlantic's territories have not yet been sufficiently opened to enable competition to significantly diminish the incumbents' market power.

ii. CLECs Will Continue to Rely Upon ILEC Cooperation to Interconnect with ILEC Networks

29. Even if local service markets were fully opened to competition, the need for on-going regulation would not soon end. Because interconnection is required whenever multiple carriers provide service over disparate networks, entrants will continue to require high-quality and timely interconnection to the incumbent's public switched network. Adequate interconnection is vital to successful competition in telecommunications markets because acceptable telephone service presumes an ability to reach any subscriber on the public switched network.

30. In addition, because ILECs have clear incentives to deny competitors access, assuring adequate interconnection requires effective regulation. ILECs' incentives to deny access arise because telecommunications markets exhibit powerful network effects that can, if regulation is ineffective, be used to preserve a dominant provider's market position. Because the incumbent supplies access to virtually all existing network customers, it is not dependent upon interconnection with CLECs to complete calls. In contrast, it is unavoidable that entrants will initially have fewer subscribers than the incumbent and will therefore depend upon interconnection with the incumbent to complete most calls. If networks are not adequately interconnected customers will prefer the incumbent's service—even if it is otherwise inferior to the entrant's—because they benefit from readily being able to make and receive calls on the public switched network. As the Commission has previously stated, absent enforceable interconnection rules,

incumbents could use their existing control over access to the subscriber base to suppress entry.⁴⁰

31. While CLECs have no realistic alternatives to interconnection, they could potentially limit their dependence on the incumbent by investing in duplicate network facilities. But building network facilities is costly, time-consuming and, from the public interest or cost-minimizing perspective, potentially wasteful. In addition, network facilities are largely sunk costs that increase the risk of entry for CLECs, raising an additional entry barrier. And because facilities represent fixed costs, they increase the market penetration needed to achieve profitability. For these reasons, investments in network facilities are unlikely to diminish significantly CLECs' dependence on interconnection in the near future.

E. The Proposed Out-of-Region Entry Strategy Will Not Expand the Competitive Alternatives Available to Residential Customers in the Near Future

32. The *Merger Application* describes an out-of-region entry strategy that calls for Bell Atlantic and GTE to expand into 21 urban centers outside the combined company's service area.⁴¹ The merged company intends to leverage Bell Atlantic's existing customer relationships with large businesses to build a presence in out-of-region markets. Once the merged company has successfully attracted enough large

⁴⁰ "We are concerned that existing interconnection policies may not do enough to encourage the development of CMRS, especially in competition with LEC-provided wireline service. ... [I]t is important that the prices, terms, and conditions of interconnection arrangements not serve to buttress LEC market power against erosion by competition." *LEC-CMRS Interconnection Proceeding* at ¶2.

⁴¹ Public Interest Statement at 6.

business customers to recover its largely fixed investments in facilities, it will target consumer and small business customers.⁴²

33. If, through pursuing the proposed out-of-region entry strategy, Bell Atlantic and GTE aggressively entered residential local exchange and access markets, the benefits to consumers could be substantial. There is little reason, however, to suppose that this upbeat outcome is likely in the near term. Bell Atlantic and GTE have not explained how, after establishing service to the Fortune 500 companies that are the plan's initial service target, they will be able to profitably serve residential and small business customers. Indeed, the strategy that Bell Atlantic and GTE have presented in this proceeding bears considerable resemblance to the strategies followed by facilities-based CLECs like MFS, TCG and MCI Metro, and none of these carriers have found it profitable to enter residential markets on a significant scale. Bell Atlantic and GTE have not provided evidence to demonstrate why the out-of-region entry strategy would allow them to succeed where others have foundered. It is widely accepted that the customer service needs and marketing methods employed in the large business market segment differ in important ways from those in the small business and residential market segment.⁴³ For example, an important asset for successful mass market entry is an established brand name.⁴⁴ Bell Atlantic and GTE have not explained how their out-of-region service experience with Fortune 500 companies will aid

⁴² Kissell Declaration at 4-5.

⁴³ See Appendix B for a more detailed discussion of the different demand patterns in the large business and residential and small business market segments.

⁴⁴ See *Bell Atlantic-Nynex Order* at ¶70 ("The remaining four most significant market participants distinguish themselves from the universes of actual and precluded competitors and of other market participants by their experience and strong brand reputation in the provision of telephone service to the mass market.").

development of the marketing skills and brand name needed to successfully compete in the mass market.

IV. CONCLUSION

34. Bell Atlantic and GTE possess substantial market power in local exchange and access services markets. That market power largely stems from control of access to customers: SBC and Ameritech each serve dominant shares of switched access lines in their service regions, and local service competitors require their cooperation to complete calls on SBC's and Ameritech's local networks. Absent high-quality and timely interconnection, competitors will be unable to offer a viable service alternative.

35. In addition, entry is unlikely to significantly diminish the market power possessed by Bell Atlantic and GTE for years to come. First, the proposed merger eliminates a significant potential entrant into each service region. Second, as several state commissions have consistently found, local markets in the states served by Bell Atlantic and GTE are not yet sufficiently open to enable competition to thrive. Furthermore, Bell Atlantic and GTE control the pace at which their markets are opened to competitors because they control access to those customers.

36. Even if markets were fully opened to competition, the need for regulatory oversight of Bell Atlantic and GTE would not soon end. Interconnection is required whenever multiple carriers provide service over disparate networks. Because incumbent local exchange carriers have clear incentives to deny competitors access, assuring adequate interconnection requires effective regulation.

37. This merger does not satisfy the Commission's public interest standard because it preserves the dominant market positions of Bell Atlantic and GTE and it fails to materially improve the prospects for competition in any relevant market.⁴⁵

⁴⁵ *Bell Atlantic-Nynex Order* at ¶36.

APPENDIX A: Curriculum Vita for Dr. John B. Hayes

The Tilden Group, LLC
5335 College Avenue
Oakland, CA 94618
510-595-2707
jhayes@tildengroup.com

Education	University of Wisconsin, Madison, WI Doctor of Philosophy in Economics, 1994 University of Denver, Denver, CO Master of Arts in Economics, 1986 Stanford University, Palo Alto, CA Bachelor of Arts in Economics, Stanford University, 1983
Awards	1992 Federal Reserve System Board of Governors Dissertation Fellowship 1986 University of Denver Fellowship
Current Position	Senior Economist, The Tilden Group, Oakland CA September 1997 - present Economic analysis to support antitrust litigation in high technology and communications industries.
Professional Experience	Economist, U.S. Department of Justice, Antitrust Division, Washington, D.C. 1993 - 1997 Economic analysis to support antitrust litigation and Federal competition policy. Advised and trained foreign competition agency personnel. Extensive telecommunications experience includes comments filed with the Federal Communications Commission and analysis of the AT&T-McCaw and Bell Atlantic-Nynex cellular mergers. Adjunct Professor of Economics, Georgetown University, Washington D.C. 1995 - 1996 Taught an undergraduate course in industrial organization. Research Assistant, Wisconsin Vocational, Technical and Adult Education System, Madison, WI 1989 - 1991 Economic analysis of labor market trends affecting enrollment in the VTAE system.

Project Manager, US WEST, Strategic Marketing Division, Denver, CO
1987 - 1988

Identified new business opportunities. Compared the performance of business units to industry benchmarks. Trained staff in the use of data resources for business performance analysis.

Research Assistant, Medical Group Management Association, Center for Research and Ambulatory Health Care, Denver, CO
1986 - 1987

Survey design, implementation, analysis, and presentation of results. Authored articles for the association newsletter and journal. Maintained research databases. Prepared research proposals.

**Research
Papers**

- 1994 Hayes, John B. "Do Firms Play Exit Games? Theory and Evidence on the Strategic Role of Size in an Exit Game." Ph.D. dissertation, Department of Economics, University of Wisconsin-Madison.
- 1994 Hayes, John B. "An Exit Game with Continuously Adjustable Output and Efficiency Differences." Working paper, Department of Economics, University of Wisconsin-Madison.
- 1993 Hayes, John B. "Do Firms Play Exit Games? Some Evidence on the Strategic Liability of Size." Working paper, Department of Economics, University of Wisconsin-Madison.
- 1992 Eisner, James and John B. Hayes. "Labor Market Information for the Trade and Industry Occupations." Wisconsin Board of Vocational, Technical and Adult Education, Madison, WI.
- 1990 Hayes, John B., Catherine M. Cotter, and Ronald J. Hustedde. "Labor Market Information for Business and Marketing Occupations." Wisconsin Board of Vocational, Technical and Adult Education, Madison, WI.
- 1990 Hayes, John B. "Optimal Exit Strategy in a Stochastically Declining Market." Applied Microeconomics Workshop, Department of Economics, University of Wisconsin-Madison.

APPENDIX B: Relevant Markets for Public Interest Analysis

A. Principles of Market Definition

1. In assessing whether a carrier has market power, and whether a merger is likely to harm competition, it is helpful to define relevant markets. Economists generally define market power as the ability to maintain prices above competitive levels for a sustained period of time.⁴⁶ Properly defined markets are a useful tool for assessing the competitive effects of mergers and other business practices.
2. Relevant markets are usefully defined along two dimensions: (1) the collection of products or services to be included in the market; and (2) the geographic scope of the market. Within each dimension, economists determine the scope of a relevant market by the existence of demand substitutes.⁴⁷ Those products that consumers view as good substitutes are properly included within the market. Products that consumers perceive as poor substitutes are excluded from the market. The Commission adopted this approach in the *LEC In-Region Interexchange Order* and the *Bell Atlantic-Nynex Order*.⁴⁸ In a correctly defined market, a hypothetical monopoly producer of all of the products or services included in the market could profitably raise price(s) above competitive levels for a sustained period of time. In contrast, any market in which a monopoly producer

⁴⁶ Alternatively, one could define market power as the ability to maintain quantity or quality below competitive levels for a sustained period of time.

⁴⁷ U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, April 2, 1992 (revised April 8, 1997).

⁴⁸ *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, Second Report and Order, FCC 97-142, released April 18, 1997 ("*LEC In-Region Interexchange Order* ") at ¶27 and *Bell Atlantic Nynex Order* at 50.

could not sustain a price increase would not be a useful tool for assessing the possible exercise of market power following a merger.

B. Relevant Product and Geographic Markets

3. SBC and Ameritech provide a diverse and expanding array of telecommunications products and services. These products and services are usefully grouped into two categories. Retail services, such as Centrex and basic local service, are provided in downstream markets to end users. Wholesale services, such as access and the provision of unbundled network elements, are provided in upstream product markets to other network providers. At both the wholesale and retail levels, many of these services could potentially be considered distinct relevant markets.⁴⁹ In this declaration I focus on the provision of two core services—basic local exchange service and access—that are fundamental to many, if not most, of the network services provided by the merging parties. Competitive conditions in these markets are likely to be similar to those in other markets relevant to an analysis of the competitive effects of the merger.

4. An ability to complete calls ubiquitously over the public switched network is an essential characteristic of telecommunications. Access services provided by ILECs are fundamental to this ability, as they allow carriers to complete calls on distant and disparate networks. Access services can take many forms.⁵⁰

Horizontal access arrangements allow competitors to interconnect their network

⁴⁹ Long distance services may be an additional relevant market. As SBC and Ameritech are new and comparatively small participants in long distance services, I have not addressed long distance services in this declaration. For similar reasons, I have not addressed bundled long distance and local services.

⁵⁰ See Ingo Vogelsang and Bridger M. Mitchell, *Telecommunications Competition: The Last Ten Miles*, MIT Press, 1997 at 12-17.

with the incumbent's local exchange network. Vertical access arrangements permit providers of complementary services, such as long distance or wireless services, to originate and terminate calls on the local network. In this declaration I will use the term access expansively to refer to all forms of access to the local exchange network in a specific local service area.⁵¹ As there are no viable substitutes to access, this service is a relevant market.⁵²

5. Local telephone service, broadly defined, is a collection of services that includes the capabilities (1) to originate calls from a specific location and terminate them anywhere on the public switched telephone network, and (2) to receive calls from any point on the public network. As a practical matter, there are no viable substitutes for local service, and therefore this product constitutes a relevant market.

6. There are many specific locations to originate calls within local telephone networks and consequently, there are many distinct relevant product markets within a local service region. It is also true, however, that within any particular geographic region there is a limited set of carriers that have facilities in place to provide local telephone service. Within this region, the range of competitive alternatives and, more importantly, the nature of competition between the alternative suppliers, may be very similar. It can be useful in such circumstances to aggregate these similar product markets and assess competition in the aggregate

⁵¹ It is worth noting that this definition does not encompass special access arrangements that provide access to interexchange networks but do not directly provide access to a local exchange network.

⁵² More narrowly defined access markets may also exist. The competitive effects of the merger in more narrowly defined markets are unlikely to differ substantially from those identified in this broadly defined market.

market as a whole. Because consumers face the same set of choices within this area, the competitive effects of the merger can be accurately analyzed within the aggregate market.⁵³

7. For many telecommunications markets, such aggregation may be more than a convenient way to simplify the analysis. When competition takes place simultaneously over multiple markets, it is often useful to gauge the competitive significance of market participants in an aggregate market that encompasses the full set of markets where firms simultaneously compete. Residential and small business telecommunications services in particular are marketed through mass media outlets which reach potential customers spanning large areas. The economies of scale inherent in this kind of marketing compel competitors to provide service to the entire area addressed by their marketing efforts. As a consequence supply conditions, especially those in the residential and small business customer segment, provide an additional reason to assess competition within aggregate local service markets.

8. SBC and Ameritech provide local telephone service to customers in certain well-defined geographic areas. The competitive alternatives for service available to customers in these local service areas are generally sufficiently similar to treat each local service area as a separate relevant market.

9. An alternative approach to defining a local service market begins with the observation that telephone calls are point-to-point (or in some cases point-to-multipoint) connections, so one could potentially think about each call from a

⁵³

See the *Bell Atlantic-Nynex Order* at ¶51 and the *LEC In-Region Interexchange Order* at ¶5.

specific origination point to a specific termination point as a unique product.⁵⁴ As there are no viable substitutes for specific point-to-point telephone connections—a call from the office to home cannot substitute for a call from the office to a client—each point-to-point connection constitutes a distinct relevant market.⁵⁵

10. Taking point-to-point calls as a product therefore leads once again to the conclusion that there are many distinct relevant product markets. For the same reasons described above, however, it is both convenient and analytically useful to aggregate those markets where the competitive alternatives are similar. Such an aggregation leads to the same set of local service areas identified above.

11. The two alternative approaches to market definition for local exchange services described in this section lead to an identical collection of relevant markets for an assessment of the competitive effects of the merger: the local service areas in SBC's and Ameritech's service regions. Economic analysis of the merger is unaffected by a decision to adopt one approach to market definition over the other.

C. Market Segments

12. It is widely accepted that the patterns of demand for some customer groups are sufficiently distinct that they require separate analysis. The Commission has previously determined that within local exchange and access services markets it is possible to identify three customer groups with distinct patterns of demand: (1)

⁵⁴ The Commission has taken this approach in several recent decisions. See the *Bell Atlantic-Nynex Order* at ¶51 and ¶54 and the *LEC In-Region Interexchange Order* at ¶5.

⁵⁵ Defining local service markets around point-to-point calls suffers from the defect that local service is not typically sold on a point-to-point basis. Instead, local service is sold in a bundle that includes a general ability to terminate calls to any point on the local network. This fact indicates that it may not be economically viable to offer local service on a point-to-point basis.

residential and small business customers, (2) medium-sized business customers, and (3) large business and government customers.⁵⁶ These groups are distinguished by the different characteristics of their demands for local exchange and access services.

13. The large business and government customer segment consists of customers who typically:

- generate traffic volumes that require multiple high-capacity lines (*e.g.*, DS1s and DS3s) for their local exchange and access services;
- purchase a wide array of complex telecommunications services such as ISDN, frame relay and Centrex;
- negotiate firm-specific contracts;
- have dedicated, professional telecommunications services managers on staff; and
- require a premises visit to initiate service.

In contrast, residential and small business customers typically:

- generate traffic volumes that can be supported by one or two voice grade lines;
- purchase local service together with vertical features such as call waiting or caller ID; and
- rarely require a premises visit to initiate service.

The demand patterns for medium-sized business customers are intermediate between those of large business customers and residential and small business customers. Medium-sized business customers typically generate traffic volumes that require multiple voice-grade lines but not multiple high-capacity lines.

14. Reflecting the complexity and scale of their purchases, local telephone service for large business and government customers is generally marketed through

⁵⁶ *Bell Atlantic-Nynex Order* at ¶53.

dedicated account representatives who visit the customer's premises to describe service offerings. In contrast, service is marketed to residential and small business through mass media and to medium-sized business customers by specialized firms.

15. Consistent with their high traffic volumes and demand for complex telecommunications services, local service revenues are concentrated in large business customers. The largest one percent of local service customers account for roughly 30 percent of revenues.⁵⁷ Business customers of all types utilize 32 percent of switched access lines nationwide; residential customers account for 67 percent of all access lines; and pay telephones account for one percent.⁵⁸

16. These three customer segments exhibit sufficiently different demand patterns that the competitive effects of the merger should be separately assessed for each market segment. Large, and to a lesser extent medium-sized, business

⁵⁷ Vogelsang and Mitchell *op. cit.* at 29, citing *Bypass of the Public Switched Network*, Third Report and Order, released May 26, 1987 at 32.

⁵⁸ *1997 Preliminary Statistics of Common Carriers*, Federal Communications Commission, ("1997 Preliminary SOCC ") Table 2.5.

customers are most readily served by CLECs because their traffic volumes profitably support the provision of multiple access lines.⁵⁹ As a result the competitive effects of the merger could differ significantly across the three customer segments.

⁵⁹

The competitive effects for small business customers may, in fact, differ sufficiently from residential customers that it also would be useful to separately assess effects in this customer segment. Residential service generally is priced at lower rate than business service. This pricing difference could potentially support greater entry opportunities for CLECs in the small business segment than in the residential segment, even if traffic volumes for these two customer groups are comparable.

APPENDIX C: Data Sources for Table 5

1. **CLEC On-Net Lines.** An estimate of fully facilities-based (on-network) CLEC lines was reported in the Atlantic • ACM survey,⁶⁰ which contains data as of December 31, 1997. In order to maintain consistency in the table, I chose to obtain other data from this same time period where possible.

2. **Unbundled Network Element (UNE) Loops.** CLEC purchases of unbundled loops were derived from the following sources:

- *First Local Competition Survey*, data as of December 31, 1997. These data were used for the DC, Maryland and Pennsylvania estimates.
- *Second Local Competition Survey*, data as of June 30, 1998. These data were used for the Delaware and Virginia estimates.

New Jersey Board of Public Utilities reported that CLECs in New Jersey provided no residential lines and 6700 business lines.⁶¹ Given the Atlantic • ACM survey estimate of 875 CLEC on-net lines in New Jersey, I estimated business UNE loops to be 5,825.

3. Apart from the New Jersey data, the available data on UNE loop counts did not distinguish between residential and business loops. Using Brooks Fiber's experience in Michigan, as reported in the *Harris-Teece Michigan Affidavit*,⁶² as

⁶⁰ *An Analysis of Local Switched Services Market Share in the Bell Atlantic-Delaware Region*, provided by Atlantic • ACM. This survey was sponsored by various corporations, including Sprint Telecommunications.

⁶¹ *In the Matter of the Board's Investigation Regarding the Status of Local Exchange Competition*, "Report and Action Plan," Docket No. TX98010010, July 1998 at 10.

⁶² *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in*

well as Brooks Fiber's report to the Michigan PSC that 90 percent of its residential customers are on unbundled loops and 10 percent of its residential customers are on fully facilities-based lines, I estimated that 46.25 percent of the unbundled loops reported for Bell Atlantic and GTE in the *Local Competition Survey* serve residential customers. This estimate probably overstates the fraction of unbundled loops serving residential customers, as Brooks Fiber targeted residential customers in Michigan more aggressively than did CLECs in other locations.

4. **Total ILEC Lines.** Total ILEC lines, including lines sold directly to end users and those sold to competing local exchange carriers for resale, was provided by Bell Atlantic and GTE in the *First Local Competition Survey*.

Michigan, Joint Affidavit of Robert G. Harris and David J. Teece On Behalf of Ameritech Michigan, CC Docket 97-137 ("*Harris-Teece Michigan Affidavit*").

NOV 23 1998
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

for Consent to Transfer of Control

))))))))

AFFIDAVIT OF KEVIN E. BRAUER

Bell Atlantic's (BA) proposed merger with GTE Corporation (GTE) is a significant threat to Sprint's and other companies' ability to compete for telecommunications business in the home areas of BA and GTE and thus a threat to the welfare of telecommunications customer in their areas. If these companies combine, they will control vital last mile facilities to 58 million access lines across thirty-two states. This is more than one-third of the access lines in the United States. My affidavit will describe many of the blatantly anticompetitive actions of both BA and GTE, and why a merger of these two companies neither bodes well for the advancement of the Federal Communication Commission's ("FCC's") pro-competitive goals nor brings benefits to consumers. While GTE is not technically a Regional Bell Operating Company ("RBOC"), it is currently larger in terms of access lines and revenues than any of the original seven RBOCs. For purposes of this

affidavit, I will refer to the RBOCs and GTE collectively as the Incumbent Local Exchange Carriers ("ILECs").

I will explain the plans Sprint has to compete with the ILECs and detail some of the significant problems that the ILECs potentially cause Sprint. BA combined with GTE, has the power to harm local competition by providing poor access to their last mile and collocation space facilities as well as by refusing to cooperate with competitors' requests for new ways of providing essential inputs (new or existing) that may be needed for the provision of new services. The large scope of the combined company increases the opportunity for one company to negatively affect a very large part of the market. Based upon the serious roadblocks that Sprint has faced reselling BA's local exchange service post-BA/NYNEX merger, I am deeply concerned that the BA/GTE merger will exacerbate the problems by compounding each companies' anticompetitive tactics across a wider region.

Before providing this detail, I will briefly set forth my relevant experience in the telecommunications field. I am the President of Sprint's National Integrated Services organization. As President of this organization, I am responsible for implementing Sprint's new, innovative, state-of-the art technology platform and service. Sprint recently announced this new platform and service - Sprint ION, Sprint's Integrated On-demand Network.

I have held my current position for the last year. Before that, I was the President of Sprint Business, the group responsible for serving Sprint's larger business customers. I have also served as a Sprint senior vice president responsible for developing and

implementing strategies related to Sprint emerging growth opportunities and held various vice presidential level marketing assignments.

II. Sprint ION Deployment

The Telecommunications Act of 1996 encourages both the development of competition in local exchange markets and the deployment of advanced services to consumers residing in the United States. Sprint ION assists in meeting both goals: it brings competitive communications offerings to current local exchange carrier (LEC) monopoly customers and it does this through the use of advanced technologies created for the data age rather than the technologies used in the provision of yesterday's plain old telephone service.

The networks and technology deployed by traditional telephone companies, both local and long distance, rely upon circuit switches to route both local and long distance voice traffic using a time division multiplexing (TDM) technology. While voice comprises the bulk of the communications traffic today, data traffic is increasing rapidly. We are experiencing a rapid growth in use of the Internet and the developing capability of converting voice TDM traffic to a data format that can be carried on more modern data networks. Data traffic is growing at a much more rapid pace than traditional voice traffic and is expected to be the bulk of the communications traffic in the near future.

Sprint's new ION service integrates traditional voice TDM traffic, Internet traffic, Frame Relay traffic, and other data traffic on one customer access facility and carries all of this traffic in the asynchronous transfer mode (ATM) data format through the Sprint network. The initial conversion of these various formats takes place at the customer

premises where all of the traffic is converted to ATM and transported to Sprint's network for delivery to the terminating point.

Sprint ION service will be capable of carrying the traffic of Sprint ION customers over any distance, whether the communication is delivered within a city, across a state, or across the nation, without regard to artificial regulatory boundaries. For communications terminating to end users that are not Sprint ION customers, Sprint will convert the Sprint ION format to the format needed to communicate with the off-net non-Sprint ION customer.

As Sprint deploys Sprint ION, it will focus customers on the efficiency gained by integrating all services on one access facility, increased functionality provided to customers through increases in bandwidth, and innovations in customer control by providing the customer with easy-to-use service configuration functionality. For example, a smaller customer will have the capability to create up to six voice communications channels where only one existed before and greatly increase the data throughput speed of its access to the Internet and other data applications. Configuration choices will be available to the customer through an easily used computer-based program.

For businesses large and small, the Sprint ION technology will enable networked multimedia applications that efficiently link employees, customers, and external partners by providing virtually unlimited bandwidth to all work locations. This will facilitate E-Commerce to help reach new markets; interactive distance learning for employees at all locations; management of a telecommuting and/or geographically dispersed workforce; and real-time video desktop collaboration, connecting both internal and external participants at multiple locations.

Sprint intends to offer Sprint ION service to large businesses using dedicated access and to smaller businesses and residential customers initially via Digital Subscriber Loop ("xDSL") access solutions. Sprint has plans to provide Sprint ION service in metropolitan areas containing over 65 percent of the population of the United States.

Initially, in late 1998, Sprint will offer Sprint ION service to a select group of customers in seven cities. In early 1999, the number of customers to whom and the number of cities where Sprint ION service is offered will increase dramatically.

Later in 1999, Sprint will begin offering Sprint ION service to smaller customers as alternatives to dedicated access service become available. One method of supplying the additional communications bandwidth required for Sprint ION service to these smaller customers is xDSL technology. Sprint will collocate xDSL equipment in selected ILEC central offices to gain access to ILEC unbundled network element (UNE) loops. A data-capable loop, one free of problems that degrade its potential performance, when connected to xDSL technology at the customer premises and in the central office, provides the bandwidth necessary for Sprint to offer Sprint ION service. Sprint's collocation program will extend into the year 2000.

In the latter half of 1999, Sprint expects to increase the functionality of Sprint ION service to include the ability to combine what had previously been local voice calling with other communications on the all-distance Sprint ION platform. The addition of this capability will allow a customer to integrate its local service with other services through a single Sprint ION service using a single access facility to the customer premises. At this point, Sprint will be providing facilities-based competition for the business of the local customer.

Sprint anticipates that ION service will not only appeal to many of its current voice and data customers, but also to additional customers seeking innovative communications solutions to both local and long distance communications needs. The typical consumer profile that is likely to be interested in Sprint ION services uses two or more local lines, an Internet service provider, custom calling features or packaged services, and has long distance usage. If the RBOCs gain authority to provide long distance service within their current operating areas, Sprint ION service will compete with the RBOCs for local and intraLATA toll services as well as in-region, interLATA service previously offered only by interexchange companies.

xDSL Availability

Sprint has considered using xDSL services offered by the ILECs. However, the issue of whether the ILECs need to offer this service to competitive telecommunications carriers is the subject of on-going proceedings at the Federal Communications Commission. Several of the ILECs have asserted that xDSL services should not be available to competing carriers for either resale or UNE use.¹ While GTE filed and recently received acceptance of an interstate ADSL tariff offering, by GTE's own admission, the offering was developed with its retail operation in mind, and does not meet the needs of Sprint ION with respect to broadband service availability. In fact, GTE's tariff would effectively prohibit direct connection to Sprint as a network service provider in that it is limited solely to those instances where the data-only service is directly connected to an Internet service provider

¹ See the petitions of Bell Atlantic, US WEST, and Ameritech that were addressed in the FCC's August 7, 1998 memorandum opinion and Order in CC Docket No. 98-147, et al. (FCC 98-188). Bell Atlantic and SBC have sought reconsideration of the portion of that order requiring ILECs to provide conditioned loops that are capable of use for xDSL service, and US WEST has sought judicial review of the order in the D.C. Circuit (Case No. 98-1410).

("ISP"). The ISP to which the service terminates must be specified in order for GTE to provide the service. Sprint ION service will not terminate directly to an ISP. Rather, the service purchased by Sprint is required to terminate directly to the Sprint network, with any and all successive terminations handled by Sprint from that point forward.

GTE's stated plans in its interstate tariff description and justification (GTOC Transmittal No. 1148 dated May 15, 1998) to offer ADSL service in 30 markets exclude numerous states where GTE has local exchange operations, including Alabama, Alaska, Arkansas, Arizona, Idaho, Iowa, Kansas, Nebraska, Nevada, New Mexico, Oklahoma, South Carolina, and West Virginia. The lack of ADSL in GTE's operating territories in many of these states could degrade the value and deployment of Sprint's ION service.

Even where ILEC xDSL service may be arguably available to Sprint, the deployment of xDSL by ILECs, as offered, does not meet the needs of Sprint for use in providing Sprint ION service. Sprint ION is an integrated, all-distance service that combines local and long distance, voice and data. The ILEC deployment of xDSL is a data only service that places additional equipment at the central office and the customer premises (via a POTS splitter) to strip off plain old telephone service (POTS) voice traffic (both local and long distance) to the ILECs circuit switched local exchange and exchange access network. This stripping of voice traffic defeats one of the primary benefits of Sprint ION – integration of voice and data using Sprint's ATM based network. In fact, GTE's ADSL tariff requires, as an essential component to the purchase of its ADSL service, that a companion local service offering be in place. As I stated earlier, Sprint ION will not require a separate POTS voice line, but will integrate all forms of end user traffic for transport over a single xDSL circuit in an ATM data format. Thus, GTE's requirement is

inefficient from a network standpoint and makes resale of GTE cost prohibitive as the essential intermediate supplier of last mile xDSL services.

Sprint desires to use the xDSL facilities and equipment of the ILECs, particularly in smaller offices where Sprint's collocation of its own xDSL equipment is not as economical because the number of potential customers is low. In these offices, sharing the xDSL equipment makes sense from a cost standpoint for all parties. Unfortunately, it appears that competitive obstructionism by the ILECs may well overcome the merits of cost sharing.

III. ILEC Roadblocks to Competition

General

Competition has been slow in coming to telecommunications markets. Long distance markets began truly opening to competition upon the divestiture of the RBOCs from AT&T. In the landmark antitrust litigation that brought about the RBOC divestiture, evidence convincingly indicated that the RBOCs had used their market power to impede the entry of competitors into the long distance marketplace. The remedy for this anti-competitive activity was separating the potentially competitive long distance market from the local exchange monopoly market. When this occurred, and the RBOCs no longer had an incentive to block long distance competition, actual competition in the long distance market blossomed and resulted in the highly competitive long distance marketplace the American consumer enjoys today. In addition, due to the potential for anti-competitive activity, GTE agreed to a consent decree placing certain restraints on it and its long distance operations.

Before the divestiture, evidence indicated that the RBOCs used their monopoly position to disadvantage competitors as they attempted to enter the long distance market.

It was shown that the RBOCs provided better terms and conditions to their own long distance affiliate than to competitors, that the RBOCs provided higher levels of service to their long distance affiliate than to competitors, that the RBOCs flatly refused to provide needed facilities to competitors, and that the RBOCs disparaged competitors. Given the fact that the RBOCs had, and continue to have, a near monopoly on the facilities needed to serve end users, these actions precluded effective competition in the long distance market.

Operational Support Systems

The ILECs retain the capability to harm potential competition in local markets and they have the incentive to exercise that power in a negative manner to delay meaningful local exchange competition. The ILECs' near monopoly in access to local customers is the key to their continuing ability to impact local competition by failing to provide quality access to those monopoly facilities to companies such as Sprint. While the Telecommunications Act of 1996 requires major ILECs to open their local markets to competition and to treat competitors at parity with itself in terms of Operational Support System (OSS) capabilities and access to facilities, the difference between words and action is clearly evident in the behavior of the ILECs. GTE has been defiant of many of the Act's requirements since its inception. For example, the Act and many Sprint/GTE interconnection agreements require automated access to the customer service record (CSR), and access to the unbundled network elements platform (UNE-P) that greatly facilitates the use of UNEs. GTE remains in violation of these agreements, borne of state PUC rulings, and has simply refused to provide an automated interface to CSR data. Repeated requests for automation of this access by Sprint have been rebuffed by GTE, which first stated that it was still not required to automate this interface, then stated that

such access was unavailable due to system limitations, and then stated that future system enhancements would allow this functionality to be provided by the fourth quarter of 1998. As we stand now in the fourth quarter 1998, GTE's current position is that, due to budget cuts, all automation and development and implementation activities related to automated access to the CSR would cease until the third quarter of 1999. Thus, if Sprint requests access to a CSR today (nearly two years after the execution of interconnection agreements requiring such automation), it must provide a written request to GTE, and GTE commits to provide the information via fax within 24 hours of the request – a far cry from the virtually instantaneous access that GTE's own customer service and sales personnel have to this information on an existing customer.

In the case of BA, over the past six months Sprint has dedicated significant resources towards the development of application-to-applications interfaces with BA. To date, Sprint has not achieved parity with the BA pre-order, order or trouble/maintenance OSS Systems. For pre-order systems, in mid-October 1998, Sprint at long last received the final documentation necessary to initiate mapping of BA pre-order systems. This final baseline document was received after several interim, incomplete versions had been distributed. Sprint has only begun the process to evaluate this final baseline documentation and proceed with computer programming. Therefore, parity with BA's pre-ordering systems has not been achieved.

For ordering systems, Sprint received the final EDI Issue 8 documentation in mid-July 1998 and initiated a large work effort to map the EDI transactions and validate business rules. Following clarification of BA's specifications, Sprint initiated software programming efforts. In early September, BA issued an emergency release of the ordering

specifications requiring business rule changes. Sprint is coding to the current EDI specifications but has not completed those efforts. Therefore, parity with BA's internal ordering systems has not been achieved.

For trouble/maintenance systems, BA's only option is the graphical user interface (GUI). The GUI has inherent flaws that ensure that parity will never be achieved. Specifically, CLECs must enter trouble information into their own individual trouble/maintenance systems. Then, the CLEC must reenter much of this same information into the GUI. This dual entry is not at parity with BA's own single entry system. Thus, the basic design of the GUI does not allow for parity.

Sprint is active in setting industry standards for pre-order, order and trouble/maintenance systems. During Sprint's evaluation of BA North systems (those used in the old NYNEX areas), Sprint identified twenty-nine proprietary data elements that were non-industry standard. Any one of these elements, standing alone, does not create an interface development requirement that is overly burdensome. However, this large number of proprietary fields does create a large work effort to customize Sprint's OSS systems to accommodate BA's non-standard system elements. Further, many of these unique non-standard data elements are not utilized by BA South, (the area served by the original Bell Atlantic), which may have its own set of non-standard data elements. Globally, Sprint is forced to develop several iterations of code for these ILEC-specific proprietary data elements. Such multiple development unnecessarily increases Sprint's costs and delays Sprint's ability to achieve parity with BA's retail operations.

In the situations where Sprint has used the GUI for service order and repair, Sprint has had numerous connection problems. Sprint's GUI users are required to obtain authorization from BA to log-on to the GUI system and BA has delayed that authorization for many weeks. During this delay our new customer service agents were unable to log-on to BA's systems. Further, the dial-

up log-on process has been fraught with problems where when connecting to the GUI, Sprint encountered hours of busy signals, ring-no-answer, and disconnections. This has all be complicated by the fact that BA has changed log-on procedures and its help desk rarely answers telephone calls.

State Commission Competition Rulings

Both BA and GTE have claimed that they have met their obligations under the 1996 Act.² However, in several cases examined by state public utility commissions, both companies have been found to have failed to meet the OSS, access and Section 271 competitive checklist requirements of the Act. For example, Sprint actively participated in the New York Public Service Commission's proceedings regarding BA's compliance with the Act's checklist requirements. Bell Atlantic has been unable to demonstrate that it has satisfied the check list and other requirements such as OSS parity, access to UNEs, and collocation on reasonable terms and conditions in New York or any other state. BA has not even attempted to gain FCC approval of its 271 obligations. Recently, the New Jersey Board issued a report finding that there is no significant residential or small business local telephone competition in New Jersey, and it identified BA's lack of standardized OSS and access to UNE combinations to be two major barriers to entry.

GTE has been one of the leaders in challenging the Act's provisions before state regulators and the courts. In fact, GTE vigorously opposed Sprint's 252(i) election of the AT&T/GTE interconnection agreements in each instance where Sprint sought such an

² See, e.g. testimony of Dan Whelan, President of Bell Atlantic-Pennsylvania, where he went through each item of the 14 point competitive checklist and proclaimed them to be "done." At the beginning of his testimony, he told the Commission that Bell Atlantic's "goal here today is to convince you that we have complied totally and fully with the 14-point checklist and that the public interest demands our entry." Implementation of the Telecommunications Act of 1996; Bell Atlantic-Pennsylvania's Entry into In-Region IntraLATA Services Under Section 271, Docket No. M-960840, April 3, 1997 Hearing Transcript at 8-18 (PA. P.U.C.) The Commission did not find that the checklist had been met.

election, claiming that Sprint had no right to elect under this provision of the Act because it had already entered the arbitration process with GTE directly. None of these states upheld GTE's claim and Sprint has elected the AT&T/GTE interconnection agreement in each instance where that agreement was ripe for election. The only tangible result of GTE's litigious approach to Sprint's market entry initiatives is to add to Sprint's legal costs and extend the time that Sprint is required to spend securing an effective interconnection agreement with GTE. Even when it was made abundantly clear by the PUC or federal district court that Sprint was entitled to the 252(i) election it sought, GTE executed the agreement, but footnoted the signature, stating that GTE does not consent to the agreement and that it was executed under the duress of a state PUC order requiring such a signature.

Similar contractual problems have occurred with BA. Sprint has twice signed interconnection agreements prepared by BA only to have BA fail to sign and file the contracts in a timely manner. The first instance occurred when Sprint signed and then delivered a New Jersey interconnection agreement on May 19, 1998 while BA signed on June 2, 1998 (a two week delay) and then filed the document with state regulators until July 31, 1998 (an additional two month delay). The same scenario is reoccurring with the Pennsylvania Sprint/BA interconnection agreement. In the Pennsylvania situation, Sprint signed the Bell Atlantic prepared contract and then returned it to Bell Atlantic on November 4, 1998. As of the preparation of this affidavit, it is Sprint's understanding that Bell Atlantic will not sign the contract and that it will not be filed with state regulators. BA's bad faith negotiating practices and delay places Sprint's Pennsylvania market entry in jeopardy. BA's unilateral action to withhold finalizing good faith negotiations in

Pennsylvania also places Sprint's market entry plans in Washington, D. C., Maryland, Virginia, West Virginia and Delaware in jeopardy. Sprint and BA had agreed to use the New Jersey contract as the template for Pennsylvania and these other states. BA's ability to refuse to enter into contracts that, at its whim, it chooses to reject after thorough negotiations with Sprint underscores its ability to hamper competitive entry in its markets.

The conclusion to be drawn from these failures is that neither BA nor GTE have embraced competition and relaxed their hold on local markets.

Today, all long distance carriers remain largely dependent upon the ILECs for access to their customers. In this regard, Sprint is like other interexchange carriers. As Sprint expands from its long distance customer base to serve all-distance Sprint ION customers, Sprint is dependent upon both BA and GTE for last mile wire line access to end users. As I explained previously, Sprint ION service will reach customers through either a dedicated access line purchased by Sprint from an ILEC (in most instances), through an xDSL loop and collocation space leased from an ILEC or, potentially through a resold ILEC xDSL service if a compatible service becomes available at a reasonable price. In all of these cases, the ILEC owns the last mile of access (although CAP alternatives may be available for dedicated access to some degree). In the case of xDSL collocation, the ILEC also controls the central office space where xDSL equipment must be located to connect with the copper loops of the ILEC in order to function. In the case of xDSL service provided by the ILEC, the ILEC controls the total xDSL access facility.

Performance Measurements

The ILECs have many ways to exercise their ability to harm Sprint in its drive to compete in the local market with the ILECs. In order to compete in the local market Sprint needs efficient, standardized OSS that allow productive and timely pre-ordering information and ordering of facilities and services from the ILEC. These systems should provide parity performance with the systems used by the ILEC itself in its retail operation. As has been found by many state commissions and the FCC, these standardized systems do not exist today. Even when measurements are established by an industry work group including BA, as in New York's Carrier-to-Carrier measurements work group, BA has not complied with its agreement to provide such measurements as Design Record Layout Timeliness, OSS Repair Response Time, and the entire category of percentage of orders completed within a presubscribed period.

Automated flow-through without manual intervention is another critical issue associated with OSS. CLEC orders must flow-through the ILEC system at parity with the ILEC orders. To date, neither BA nor GTE have provided any empirical, verifiable data regarding the flow-through of their own orders. Without such measurement, Sprint has concluded that CLEC orders are not processed with the same speed and precision as BA or GTE retail orders.

Further, Sprint installation and maintenance orders must be worked in the same time frame as ILEC end user orders and both sets of customers should receive parity treatment. Parity service does not exist today, and ILECs resist creating measurements to quantify the disparity. The FCC has a proceeding proposing model measurements, but it has not suggested it will require use of these measures. Further, many states lack reasonable

measures that identify and quantify the disparity. In New York, where the Commission is working toward meaningful measurements, it was noted in a BA proceeding that installation of CLEC UNE loops takes three times longer than BA's provision of its own retail service.

In a facilities-based environment, the ILEC must also provide quality and timely interconnection, reasonable collocation conditions, and reasonable, cost-based pricing. In Sprint's view, these conditions have not yet been met and there are significant questions concerning the ground rules for meeting these needs. Take interconnection as an example. Sprint ION service is an integrated all distance, local and long distance, voice and data product. Sprint's efficiency depends on aggregating all of the customers' traffic over a single access network and Sprint's efficiency is improved through a single interconnection with the ILEC. It remains unclear whether ILECs will allow Sprint to operate in this manner.

Costing Issues

The ILEC has control over each of the elements that relate to its monopoly control over last-mile facilities. The failure to provide any one of these functions on a reasonable, timely, and cost effective basis has great impact upon Sprint's ability to succeed in the local exchange market. As discussed, the terms and conditions under which these elements are offered (if they are offered at all) do not allow for viable access for competitors.

GTE's position in the interconnection arbitrations was that, in the face of TELRIC costing requirements, it was entitled to recovery of the monopoly embedded investment in the derivation of interconnection and unbundled network element prices. GTE did not prevail on this point but it is my understanding is continuing to press this issue by litigating

what it claims are constitutional rights to embedded cost recovery. If successful, these efforts would saddle new market entrants with a full allocation of the firm's total embedded investment. But even if unsuccessful, GTE will still have succeeded in creating additional uncertainty and risk for new entrants.

Parity

In general, the ILECs have failed to provide sound and capable OSS for CLEC use in ordering services and facilities from the ILECs. This failure results in a better level of service for ILEC end users than for the customers of competitors. The ILECs have also failed to provide parity service regarding installation and maintenance of their facilities used to serve customers of their competitors as compared to that provided their own end users.

These two problem areas create both a real and customer perceived quality gap between the ILECs' service and the services of their competitors. In addition, these problems greatly and needlessly inflate the operational and customer service costs of competitors because time is spent manually processing orders and following up with customers and the ILEC concerning ordering, installation, and maintenance. This inefficient customer service activity significantly raises the cost of customer acquisition and keeps competitors from being successful in the market. Further, the OSS and related problems with the ILECs result in a significant loss of revenue to Sprint due to delayed cut-over of service, loss of customers, and damage to Sprint's reputation as a quality telecommunications provider. Sprint continues to face actual unresolved problems in this area.

There are numerous issues of operational parity that Sprint continues to fight with GTE on a daily basis and that GTE has still not resolved. I will highlight only three of the

problems to illustrate the anticompetitive stance that GTE takes in its approach to opening its local markets to competition.

First, and perhaps most serious, is GTE's continued billing of its own retail intraLATA toll to Sprint's California local end user subscribers. At the time Sprint chose to enter the California market as a competitive local service provider, it chose to resell GTE's intraLATA long distance product. However, Sprint discovered that its local subscribers were continuing to receive GTE intraLATA toll bills. In July, 1997, GTE was made aware of the problem, and the issue was formally logged for resolution. After many months of analysis and claims that the problem was "fixed", it was finally determined that system limitations prevented the recognition of a Sprint local subscriber account on the GTE system as being a Sprint account. Specifically, indicators in the GTE system that are supposed to identify the customer record as a Sprint account were not present, causing GTE's system to recognize the account as still being an active GTE retail account. While this caused Sprint subscribers to receive GTE intraLATA bills, many of these Sprint customers were being disconnected by GTE for nonpayment of the GTE bill – a bill that, by GTE's own admission, never should have been issued in the first place.

In one instance in particular, an end-user brought Court action against Sprint, the California PUC, and GTE. In ruling on the case, the presiding magistrate found all culpability resting with GTE, thereby exonerating both Sprint and the CPUC from any wrongdoings. After numerous missed commitments by GTE, Sprint issued an ultimatum to GTE in July, 1998 (a full year after the problem was identified) – either fix the problem permanently and systematically, or face formal legal action. In response, GTE took steps (that are still in place today) to manually examine each Sprint account for the missing

indicator and edit the customer record if it is in error, pending a systematic solution. Each attempt at a systematic solution has failed, and Sprint's customers are still receiving GTE bills. Even GTE's band-aid solutions have failed and have only served to exacerbate the problem.

Second, GTE charges Sprint three times the amount that it charges its own end users for a change of the primary interexchange carrier (PIC). In response to Sprint's claim of anticompetitive and disparate treatment, GTE contends that it must process a local service request (LSR) to make the PIC change triggering a separate "service order charge", while GTE's retail operation does not charge their end users this "service order charge" because they are able to input the order directly into their system without the need for a service order. However, their input of the order is equal to the input of Sprint's LSR. Additionally, GTE has established procedures such that Sprint will never be able to input its orders directly into the GTE retail system – all changes to Sprint customer accounts must be made via the LSR. Thus, Sprint will effectively never be able to avoid this charge, causing significant cost disparity, not to mention the numerous failure points introduced in the LSR process.

Finally, due to GTE's manual processing of Sprint's LSRs, Sprint is experiencing a high number of LSRs that are, by GTE's own admission, rejected back to Sprint in error. All of Sprint's LSRs require manual intervention by GTE, which leaves them open to human interpretation and error. Rejects cause undue delay in the provision of service. GTE's erroneous rejections of Sprint's LSRs only serve to exacerbate this problem because Sprint must then engage in extensive dialogue with its customers and problem solving, causing expense on the Sprint side and ultimately resulting in poor quality service to

Sprint's end users. To place GTE's actions in perspective, GTE defined parity as being parity between new entrants, not the common definition which is parity between the ILEC and new entrants. It is easy to see that, from this ideological position taken as a baseline assumption for implementation of the Act, that anticompetitive behaviors day-to-day are not unexpected.

xDSL Facilities

In situations where new facility installation is required, the ILEC routinely fails to provide timely notification of facilities availability issues, which often prevents Sprint from meeting its due date commitments to customers. This forces the re-scheduling of work activity, causing not only increased cost to Sprint, but also inconvenience to customers and vendors. At best, this puts Sprint in the position of appearing inept and unresponsive to its customers, and at worst results in loss of the customer.

These problems may well be worse when Sprint begins to provide Sprint ION through xDSL and unbundled loops. xDSL technology provides the ability to carry high-speed digital signals over the existing twisted-pair copper local loops. The performance of the xDSL equipped local loop will largely depend on the condition of the individual copper pairs and the presence of other digital signals. Many existing local loops will require individual treatment in terms of conditioning in order to carry the high-speed digital signals directly to the customers' premises. As I detailed above, the standard to which these loops must be conditioned has not been established in many states. Further, an inventory of xDSL capable loops is unavailable.

Another problem is the assessment of the addressable market for xDSL services in BA and GTE territories. In its requests for physical collocation with GTE and BA, Sprint

asked for information on the scope of the market that was addressable for a broadband solution. Specifically, Sprint asked that BA and GTE provide, in conjunction with its estimate of physical collocation costs, the average loop length, the percentage of customers that reside within 18,000 feet of the central office, and the percentage of customers that reside behind digital line concentrators – each measure being a minimal but illustrative measure of the number of customers that can realistically be offered broadband services. To date, BA has not offered this market assessment data, and GTE has explicitly refused to provide the requested information.

Additionally, the ongoing performance of the conditioned loops depends largely upon whether other digital signals are carried within the same cable sheath or binder, thus raising the concern of interference from these other signals. Because the ILEC exclusively controls access to the monopoly loop, the conditioning of the loops, and the placement of digital signals within a binder group of loops, Sprint is at risk from ILEC discriminatory treatment. The fact is that standards for these binder groups have not yet been established in most states and only a few states currently have proceedings underway related to this significant problem. The fact remains that the ILEC can refuse to provide loops to Sprint, or simply provide poor quality loops that can affect Sprint's ability to either deliver service or to deliver quality service in a timely fashion.

xDSL NRCs

Even if the ILEC performs loop conditioning, it may not actually perform the required conditioning at a reasonable charge. Where the xDSL capable loop has not been identified as a UNE, the cost of conditioning has not been established. Excessive charges for either UNE loop provisioning or for loop conditioning result in a situation where the

provision of competitive local service is not economical. Indeed, not all of the ILECs have agreed to perform the necessary conditioning work or will only do so only at excessive rates.

xDSL DLC

In addition to these problems affecting UNE loop availability, many ILEC loops are behind Digital Loop Carrier (DLC) equipment that prevents the provision of xDSL service on these loops. At this point, availability of UNE loops behind a DLC is a very contentious and unresolved issue at both the FCC and the states. While there are potential solutions to this problem, the ILECs as a rule have refused to entertain requests to collocate CLEC equipment at ILEC DLC locations and to perform sub-loop unbundling for the twisted-pair copper from the DLC to the end user premises. Since many new residential and business developments are served by ILEC DLC equipment, the ILECs are denying CLECs access to these upscale customers by refusing to perform sub-loop unbundling and collocation at DLC equipment locations.

xDSL OSS

There are additional loop-related potential problems for local service competitors. Generally, the ILECs have not committed to provide timely information about which loops can be, or are already, conditioned for xDSL. This lack of efficient OSS pre-ordering systems causes competitors significant problems qualifying potential customers for service and further frustrates their ability to meet customer expectations and provide firm orders for service when contacted by a customer.

Collocation

Sprint ION initiatives can also be impaired by unreasonable collocation practices. An increasingly troublesome problem is the publicly documented ILEC claim of lack of space in ILEC central offices for physical collocation of the equipment of competitors. The ILECs have tended to make claims of space unavailability even when such space is reasonably available. Public complaints indicate the ILECs have generally been unwilling to provide detailed floor plans or allow walk throughs so that CLECs can independently verify that ILEC claims of lack of space are reasonable. This very conflict is an issue against BA in a current docketed Massachusetts complaint proceeding. Moreover, in New York, an administrative law judge found BA-NY's collocation methods to be unacceptable to support mass local market entry.

Collocation - Warehousing

In many instances where ILEC central offices appear to be full, there is unused equipment that has not been removed or administrative personnel that are not essential for the performance of network functions. This takes up space that could otherwise be reasonably used for collocation purposes. In most of these instances, the unused equipment could be removed and personnel not essential to the operation of the network could be economically relocated, thus freeing space for collocation.

Additional lack of space claims are due to unreasonable warehousing of space for potential use by the ILEC, including for the ILEC's own deployment of competing advanced services. An ILEC reserving a reasonable amount of space for its own use (not that of an affiliate) for one year for actual, planned activities should be permissible. Unfortunately, it appears that current ILEC warehousing goes far beyond this reasonable

standard and has resulted in unfounded claims of collocation space unavailability. For example, GTE took the position in an arbitration related to the development of an interconnection agreement with Sprint that it should be able to reserve central office space for the placement of its equipment for a full five years. Undoubtedly, when central office space is becoming increasingly scarce, an ILEC's ability to "lock up" space for its own exclusive use for an extended period would serve to limit the availability of space to entrants. Without collocation, there can be no competitive xDSL-based competitive services using the ILEC UNE loops.

Collocation - DSLAM

Competitors may be further hampered in their collocation activities by unreasonable ILEC refusals to allow collocation of essential equipment, including DSLAMs (digital subscriber line access multiplexers—the central office end of xDSL technology) which they claim provide too much functionality to be eligible for collocation.

For example, prior to allowing the placement of equipment in its collocation space, GTE is requiring Sprint to execute an Equipment Limitation Agreement containing the following limitation language: "Sprint agrees that their collocation equipment installed at all GTE collocation sites will be utilized for OAM&P (Operations, Administration, Maintenance, and Provision) purposes only. Also, Sprint agrees that their equipment, including, but not limited to, DSLAM and other similar equipment, will contain no intelligent router function, thereby limiting its use to that of transmission equipment or multiplexer/ integrated line concentration functions only." The bottom line is clear – unless Sprint signs the agreement restricting the use of its equipment, it will be prohibited from placing Sprint ION equipment in the collocation space.

Collocation - Timeframes

Another collocation problem that has arisen involves excessive delays in delivery of physical collocation quotes and finished space. Competitive DSL providers have reported delays in excess of one year in some cases. These delays are unreasonable and preclude competitors from bringing their services to market. They may in some instances discourage entry by some competitors entirely. Further, in a recent New York proceeding, facilities-based CLECs were nearly unanimous about BA's inability to meet the commission imposed timelines for collocation construction. This inability to meet collocation timeline commitments directly impacts CLECs' ability to enter markets and provide competitive services.

ILECs have also reportedly imposed other artificial and unreasonable barriers, including unjustified minimum space requirements, unjustified certification requirements, and excessive collocation charges that appear to have no relation to cost. Some DSL companies have reported instances where the ILEC has refused collocation absent state CLEC certification, even though the FCC ruled in its Interconnection Order that ILECs could not refuse to negotiate interconnection with CLECs based on whether state certification had been obtained.

For example, Sprint recently requested 100 sqft. of collocation from BA in four central offices. Bell Atlantic was willing to provide collocation as requested in only one of the four locations. One office was rejected because BA stated that no space was available. Sprint requested the central office floor diagrams to confirm the validity of this denial, but this request was also rejected. In another central office, Sprint was informed that space was not available today but may be available in the future. This order is still on hold. In a

third central office, BA quoted a price of nearly \$100,000 for 100 sqft. of space. These are all examples of the roadblocks to competition that CLECs face when attempting to collocate and bring competition to the BA market.

Collocation - Alternatives

A further complication is the lack of ILEC-offered alternatives to physical, caged collocation when space truly is limited. Virtual collocation arrangements typically require the CLEC to relinquish control over the installation and maintenance of its own equipment, and thus are offered only on a basis that is substantially inferior to physical collocation. Similarly, only a small number of the ILECs have offered cageless collocation, but even then, BA's cageless offering is at the artificially inflated prices they charge for physical collocation. Sprint estimates that the same floor space can accommodate twice as much equipment using cageless collocation versus the traditional physical collocation arrangement. However, BA has priced cageless collocation at the same or higher level as physical collocation even though logic suggests cageless should be less than half the cost of physical collocation. The absence of economically viable alternatives to physical collocation where space is a genuine limitation is another potential impediment to Sprint ION in particular and true competition in general.

As indicated above, Sprint intends to serve large customers via dedicated special access facilities acquired from the ILECs. While the ILECs currently have an adequate system for ordering these access circuits, Sprint is also concerned that the ILECs will begin to degrade this capability when it is used for Sprint ION service that will facilitate competition with the ILEC on a local level. Degradation of this capability could seriously harm not only Sprint ION deployment, but could also harm ongoing Sprint long distance

operations. Not counting trouble reports, Sprint's long distance arm sends thousands of new access orders per month to ILEC (many if not most of which are special access) and thus remains highly dependent upon the ILECs' congenial provisioning of access.

Collocation – Pricing

When it comes to the prices that Sprint must pay to secure the physical space in ILEC central offices, Sprint is by and large at the mercy of the ILEC. Absent state action that required TELRIC based pricing for physical collocation (of which there are very few), prices for physical collocation are established pursuant to the antiquated fully distributed cost methodologies once endorsed by the FCC prior to the Act. Even when the ILEC's physical collocation prices are established at the state level, tariff application can be very suspect. For example, GTE is attempting to charge Sprint double for the placement of power. In the instance where Sprint has ordered A& B feeds of power to its collocation space, GTE is charging Sprint for the A feed and the B feed separately, when technically, these feeds are inseparable. GTE is the only ILEC that is interpreting the application of prices for power in this manner.

Complex Services

Further, in the early phases of Sprint ION deployment, competitive local service will be provided through resale of ILEC local services to Sprint customers. The ILECs currently do not have adequate OSS systems in place to serve the larger, more complex customers that are the initial target market for Sprint ION. The OSS systems that do exist are largely dedicated to simple orders.

Sprint has experienced first hand in GTE's area the multitude of problems that arise from ILEC manual processing of orders - they get lost, delayed, changed in ILEC data

entry, and/or erroneously rejected. This leads to a poor level of service to Sprint and its customers. There are many examples of GTE improperly processing Sprint's orders resulting in erroneous order rejection. One blatant example is GTE's processing of Sprint's directory listing orders. Since GTE processes all directory listing orders manually, all of Sprint's listing orders are open to human misinterpretation which has resulted in multiple erroneous rejects. Just in the past six months, over 95 % of all directory listing orders have been rejected for invalid reasons or for reasons undeterminable by Sprint. There have been numerous joint planning and problem resolution meetings with GTE and performance by GTE has not markedly improved. Sprint is concerned that history will repeat itself and that the ILEC will harm Sprint's market entry by poor manual performance on these complex resale orders and xDSL capable UNE loop orders.

CLECs are often frustrated by the lack of properly documented ILEC product information and OSS ordering codes. Even when Sprint understands an ILEC product, pricing information is needed to make a rational business decision. Sprint has formally requested such information from BA. However, to date such product, pricing and ordering information has not been provided. As in any vendor/customer relationship, the vendor must supply a simple easy-to-use price list with ordering codes. Such price lists with ordering codes are common supplier marketing information in American industry today. Wholesalers often refer to these price list ordering codes as stock numbers, item numbers, or part numbers. BA, as a wholesale provider of services, must supply an easy to use price list for customers to make a purchase decision and order BA services. BA has committed to handle product inquiries on a case-by-case basis, however, such a resolution is slow and inadequate in a competitive market and is a significant hurdle to competition.

Many of the problems I have discussed have been fully documented in state regulatory proceedings, 706 petitions and proceedings, and FCC dockets. Some may well be on the way to being fixed through the complaint process or rulemakings. But as a provider of a technically new and dynamic service such as Sprint ION, Sprint is concerned not only with repairing each known misstep but with the problems that will inevitably arise in the future. Stated another way, the problems identified to date by Sprint and others do not define a closed set of discrimination opportunities. Especially with the dynamically changing technological environment that characterizes telecommunications, each future modification, no matter how marginal, presents the ILECs with another opportunity to delay or deny access.

We are too often told by ILECs “we don’t provide that” or “there’s no provision in the tariff for that.” This intransigence may sometimes just reflect a monopoly supplier attitude, but where there is an additional competitive incentive to delay or deny an input, companies like Sprint are especially at risk. I also fear that, if incentives to discriminate worsen (as they would with this merger), it would be virtually impossible to gain full cooperation from the ILECs, even with vigorous regulatory enforcement. As soon as watchful regulators insist that ILECs provide one particular arrangement based on a specific complaint, the ILECs will simply turn to yet another vulnerability to exploit.

In addition, even if regulators were able to rectify each instance of obstructionism as it occurred, the time required to resolve the complaints would inevitably impede our ability to deploy Sprint ION in a timely way in the combined BA/GTE territories in particular. By reducing the number of Sprint ION subscribers in the BA/GTE service areas, the attractiveness of Sprint ION to consumers in other parts of the country will also

be reduced. As a result, the ability of Sprint ION to provide competition to ILECs in general and BA and GTE in particular will be diminished until, if ever, BA and GTE provide Sprint with all of the arrangements required for Sprint ION to be fully competitive.

Because of their last mile bottleneck, the ILECs are the gatekeepers to large blocks of geography in the United States. Negative action by any one ILEC relative to Sprint ION last mile access and collocation impacts the geographic scope of Sprint ION. A reduction in the geographic scope of Sprint ION significantly reduces the attractiveness of the service to customers as the “on-net” benefits are curtailed.

While one ILEC causing deployment problems for Sprint ION is very troublesome, the creation of an entity capable of impacting 58 million access lines across 32 states is an even larger concern because of the larger scope of the geography one supplier can affect and thus impact the deployment plans and potential success of Sprint ION. As larger and larger geographic regions of the nation become problem areas for Sprint ION deployment due to the activity of a single supplier, the potential for Sprint ION meeting its full competitive promise is significantly compromised.

IV. Summary and Conclusions

To summarize, because BA and GTE have monopoly control of last-mile facilities essential for access to end users, and central office space essential to deploy xDSL technology, they have the ability to adversely impact local service competition and the introduction of new services by denying access to these facilities or degrading performance associated with these facilities. Because these ILEC last-mile facilities will be used to compete on a local basis, the ILEC has an incentive to discriminate against Sprint and other potential competitors and provide poor OSS performance,

installation and maintenance performance, and access to facilities. The control these carriers enjoy over essential inputs can be used to damage competition in the markets for local, long distance and new services. These problems will only be exacerbated if BA and GTE are allowed to merge.

11/18/98 WED 16:09 FAX 913 624 6237
11/18/98 TUR 18:18 FAX 913 534 6300

SPRINT/RICH MOORRIS NIS

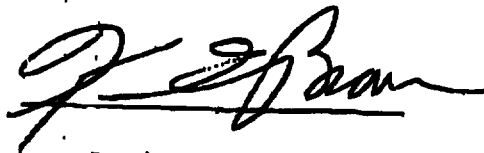
002

NATL INTEGRATED SVCS

913 534 6300

002

I hereby swear, under penalty of perjury, that the foregoing is true and correct, to the best of my knowledge and belief.



Kevin E. Brauer

Subscribed and sworn before me this ____ day of November, 1998.

Notary Public

My commission expires:

RECEIVED
NOV 23 1998
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY
In the Matter of

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of

GTE CORPORATION,

Transferor,

and

BELL ATLANTIC CORPORATION,


Transferee,

For Consent to Transfer of Control.

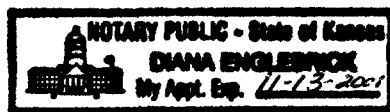
CC Dkt. 98-184

AFFIDAVIT OF GENE AGEE

I hereby swear, under penalty of perjury, that I have personal knowledge of the statements and allegations of facts contained in the attached affidavit, originally filed in CC Dkt. No. 98-141, and that it is true and correct, to the best of my knowledge and belief.


Gene Agee

Subscribed and sworn before me this 16th day of November, 1998.



Diana Englebert

Notary Public

RECEIVED

NOV 23 1998

**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In re of Applications of)	
)	
AMERITECH CORP.,)	
Transferor,)	
)	
and)	
)	
SBC COMMUNICATIONS, INC.,)	CC Docket No. 98-141
Transferee)	
)	
for Consent to Transfer Control)	
of Corporations Holding Commission)	
Licenses and Authorizations)	
Pursuant to Sections 214 and 310(d)))	
of the Communications Act and)	
Parts 5, 22, 24, 25, 63, 90,)	
95 and 101 of the Commission)	
Rules)	

AFFIDAVIT OF GENE AGEE

I. Introduction

In this affidavit I discuss the economies of scale and scope inherent in the traditional public switched telephone network ("PSTN") and Sprint's ION network. My affidavit will also discuss the technological and financial imperatives, which are the drivers of a national deployment strategy.

My name is Gene Agee and I am employed by Sprint as a Director of Finance at Sprint National Integrated Services ("NIS"). I received a Bachelor of Science degree in

Accounting from Southern Illinois University, Carbondale, Illinois in 1979 and a Masters in Business Administration from the University of Missouri at Kansas City, in 1998. As a Certified Public Accountant, I have experience in public accounting with Peat, Marwick, Mitchell and Company from 1979-1982 and private accounting as a manager of internal audit at Pizza Hut and director of internal audit for Interstate Bakeries Corporation from 1982-1987 and 1987-1989, respectively. I joined Sprint Corporation, then known as United Telecommunications, in October 1989 working in the Local Telephone Division as Manager of Regulatory Accounting for Missouri and was promoted in 1994 to Revenue Director for Minnesota, Nebraska and Wyoming. In 1996, I became Director of Decision Support for the National Integrated Services organization of Sprint. In that capacity I direct a financial analysis team assessing the economic value of Sprint's entry into emerging local telephone markets.

My group analyzes the financial impact of products and packages of services offerings including local exchange, long distance, Internet, wireless, data and customer premises equipment for all market segments. As part of my responsibilities, I must understand the economies of scale and scope inherent in technology deployment, the role of increased geographical deployment in recovering fixed costs, and the difference between fixed and variable cost. I have been deeply involved with the financial analysis that supports Sprint ION and understand the various cost components required to deliver the Sprint ION platform.

II Definition of Terms

The discussion of economies of scale and scope must begin with a clear understanding of the concepts and terms used. By economies of scale, I refer to an entity's ability to benefit from lower unit costs as volume increases. By economies of scope, I refer to an entity's ability to benefit from a national service offering. Fixed costs are those costs that are constant regardless of the actual number of customers served or units produced. Examples of fixed costs include all costs of research and development, software licensing, billing systems, operating support systems, communications databases, and control systems. Variable costs are those that vary directly with the actual number of customers served or units produced. An example of variable cost would be access charges incurred by inter-exchange carriers to originate or terminate calls over the PSTN. Finally, semi-fixed costs are those costs that remain fixed for a given level of activity, but then increase at critical points by some given amount. An example of semi-fixed costs would be costs associated with expansion of service into a new geographic area.

III Economies of Scale and Scope for the PSTN

All telephone service providers incur many costs that are largely fixed and do not vary markedly based on the number of customers. The costs of providing the PSTN using today's software intensive technologies involve both high fixed and semi-fixed costs. Semi-fixed costs arise in the form of equipment deployment that must occur in a geographical area in order to provide service. Much of the hardware used on a local basis in telecommunications, such as individual switches or copper wire to a new subdivision, may be added in a semi-fixed fashion. Much of the technological infrastructure

of a telecommunications firm, however, is either software related, and is thus a fixed cost (as discussed below), or represents core network hardware and is available in minimum sizes or definite ranges of sizes. Where this is the case, the telecommunication firms can benefit from increased utilization, so that these fixed and semi-fixed costs are spread across more users.

Examples of costs that are largely fixed include the costs of: (a) software that drives the services offered in the network; (b) back office systems that maintain customer and facility records; and (c) billing systems. Switching systems, whether they are traditional circuit switches such as a DMS 100 or 250, a Lucent 5ESS, or new generation ATM switches are in reality sophisticated computers that rely on extensive software programs to work. Interoperability between the core network switching systems and other network components also requires extensive software. In some instances, an equipment supplier develops this software on a speculative basis. In other instances, the software is custom built at the expense of the user. To the extent that the software is custom built or that licensing of the software requires a significant up-front payment that does not depend upon the volume of machines in use, significant fixed costs exist.

The costs of billing systems are another example of fixed costs to the service provider. The largest component of a billing system is software that contains the instructions on how to read and rate individual transactions, integrate multiple services, and provide a bill to the customer. This software is complex, significant in size, very expensive, and the size of the software program is independent of the size of the user. Thus, after investing in billing software development, a telecommunications company has a fixed investment that results in a lower unit cost for each additional customer billed

through the software. The billing systems used by long distance providers are not adequate for the provision of local service, and so long distance companies looking to provide local services must invest in new systems (or modify existing ones) as an incremental cost to local market entry.

Voice and data telephony providers use other complex and costly software programs to run their businesses in addition to those used in billing. For example, these systems known in the industry as operational support systems ("OSS") are used to keep records of the facilities used by each customer, the services that each customer subscribes to, the facility/service routing tables, customer history, and historical service performance. The programming of each of these OSS is complex, expensive, and the cost is basically independent of the size of the user.

Increasingly, centralized databases play a role in the provisioning of telecommunications services. Examples include 800 number databases, local number portability databases, calling party name databases, line information databases ("LIDB"), and other advanced intelligent network ("AIN") databases that are used to create new services through the manipulation of software triggers. A single pair of these databases, paired for redundancy purposes, is all that a company requires.

Much of the design and control of the network can be handled from a centralized point. The use of paired, redundant network control facilities brings economies of scale and scope as additional networks to be monitored and controlled are added at the centralized network monitoring point. Further, network designers, using standardized computer programs and network components, can design network deployments for all of the nation from a centralized point using common software. As additional engineering

work is performed using a common software platform, economies of scale and scope are realized.

What is occurring in the industry is the creation of large and complex software platforms, centralized databases, and centralized network engineering and monitoring facilities whose cost is largely independent of the size of the company deploying this technology. As a result of the largely fixed investment, great economies of scale and scope are created and available in the telecommunications industry.

The result is that any provider of a new service must consider the largely fixed costs of the offering, as well as its ability to recover these costs. Any provider of a new service will have to incur some or all of the types of fixed costs described above before it can offer that service. In addition, providers typically incur additional fixed costs over time as they improve and add functionality to their service. A company that has relatively small scale and scope has much higher per-unit costs for these functions than a company with larger scale and scope. The differences in the scale and scope of companies using these platforms and facilities translates into real marketplace differences in pricing as a smaller scale company struggles to compete with a larger company that can allocate recovery of its high fixed costs over a much larger customer base.

IV. Sprint ION Costs

Earlier this year, Sprint announced its new Sprint ION strategy which seeks to create and extend a single data network to the customer's premise to provide integrated, all-distance, voice, data and video services. Sprint owns national long distance networks today which provide voice and data services to both businesses and consumers over distinct and separate networks. The existing all digital, fiber optic long distance network

will become the backbone for the transmission of all traffic types. Sprint's previous investment in the digital, fiber optic network allows it to quickly migrate to an end-to-end high speed, high bandwidth data network.

Although Sprint ION leverages the existing long distance fiber optic network, Sprint must expend substantial additional capital to develop and implement Sprint ION in order to extend our network to the customer premise and offer a new service to customers. This new investment will have primarily fixed and semi-fixed cost characteristics. During the keynote address at Internet World, Sprint Chairman and CEO, Bill Esrey, disclosed that "we've already invested more than \$2 billion in building the network, and we have another \$400 million in investments lined up."¹ The remaining development investment, as outlined by Mr. Esrey, is smaller than the facilities investment required to deploy ION.

Sprint will need to deploy Sprint Service Nodes ("SSN"). The SSNs are physical assets deployed in target markets that run Sprint ION enabling software. The incremental cost for deploying an SSN includes acquiring the physical facilities and hardware as well as establishing physical connections to Sprint's long-distance network and the incumbent's local exchange facilities. These deployment costs are driven by both markets selection as well as the location of Sprint ION customers within the market, and, once installed are relatively insensitive to volume.

In addition to the SSNs, Sprint ION service to many business and consumer locations require the integration of all customer traffic over a common access facility through the use of a digital subscriber line access multiplexer (DSLAM), located at the

¹ CEO Chairman, Bill Esrey, Internet World Keynote Address, Chicago IL., July 15, 1998.

central office. Total estimated initial investment that will be required for the physical asset deployment of SSNs and DSLAMs is in excess of \$400 million.

Sprint ION must also develop the SSN software. Software defines how traffic negotiates the network and provides premium functionality to differentiate Sprint ION from other communication offerings. Software costs are driven by software feature specifications. Key software in the SSN includes the previously unavailable capability to offer quality voice service over packet-switched networks and the capability to dynamically allocate bandwidth by the customer. The Sprint ION Service Node will also provide what is known in the industry as “class 5 features”. These include software capabilities such as call-forwarding, caller ID, call waiting, and speed dialing that have previously been available in the network only through circuit switches.

Software development is a significant fixed cost that is insensitive to volume, and once developed, software has significant economies of scope through deployment in service nodes across a national footprint. The software to run the SSN is standardized and is being developed for Sprint at an estimated cost of \$100 million.

Sprint is also undertaking significant modifications to existing systems and the construction of many new systems to support its Sprint ION service. For example, Sprint’s existing long distance billing system is not capable of performing local billing or billing products like Sprint ION. Modification of this system and other support systems required to meet the needs of Sprint ION will cost \$320 million.

Sprint must incur each of the costs noted above to offer its Sprint ION service to customers. The estimates of development and initial deployment cost exceed \$800 million. All of these costs are either fixed or semi-fixed costs.

V. Additional Fixed Cost Activities

There are additional economies of scale and scope available to telecommunications companies. A prime example is mass advertising economies. The development of a mass advertising campaign is very expensive from a production standpoint. Examples of such advertising media include national television, national magazines, and national newspapers such as the Wall Street Journal and USA Today. Economic efficiency is gained as the geographic scope of the target market is increased. It is much more economic per customer to use national television to reach a market which include all of the United States than to use it to reach only potential customers in the State of Texas. As the size and scope of the target market increases, the cost per presentation to potential customers via national advertising campaigns is reduced.

Sprint has already begun national advertising of Sprint ION service using the television medium. Through television, business customers nationwide are being told that they will be able to subscribe to Sprint ION. At the Sprint ION announcement, Sprint presented information to the national press and received nationwide newspaper, television and other print media coverage. Sprint is using nationwide mass media to deliver its Sprint ION message to potential business and residential customers. Sprint spent \$290 million promoting its nationwide products in 1997 and anticipates a similar campaign for its suite of products that now includes Sprint ION.

Today, Sprint serves over 16 million businesses and consumers in the United States. A national customer base lowers acquisition costs, accelerates acquisition time, and, as described above, provides the opportunity to spread national marketing costs.

The national scope of Sprint ION can also leverage the existing national distribution and affinity programs such as AARP and Radio Shack used to sell current Sprint services.

VI Sprint ION's Value to Customers

Sprint ION has value to customers by offering cost savings and increased functionality and features. Sprint ION allows customers access to multiple services over a single, broadband access facility with managed bandwidth capabilities. These features enable users to make more efficient use of telecommunications services and networks than they are able to do today under the PSTN platform. Customers' access costs are lower than when they must use multiple, separate access facilities, one for each type of service. As a result, customers can be expected to have greater access capacity and capability, which in turn means the ability to exchange communications they otherwise could not. In other words, ION effectively will allow customers to utilize services they would not choose to utilize (or utilize to the same degree) at prevailing prices.

Thus, Sprint ION provides additional features and functions. At the consumer level, an access circuit that today provides only one plain old telephone service ("POTS") line would be capable of providing up to six POTS-like lines, or a combination of narrowband and broadband services managed by the customer on a dynamic, as-needed basis. The need for and costs of multiple physical access lines in order to make or receive calls (and avoid busy signals) while another member of the household is on the Internet, for example, is eliminated. As another example, the Internet access that blocked calls today over the analog loop can occur over the digital loop not only simultaneously with a voice call but also at much greater speeds. For business users, network use also becomes more efficient. Today, for example, an ordinary private line customer with a

dedicated access link is able to pass traffic at given speeds or below subscribed for in advance. If the private line service is integrated on Sprint ION, however, the customer's data traffic could use the much larger integrated access link to pass the traffic at much higher speeds, again on a dynamic, as-needed basis. With Sprint ION, business customers no longer will be forced to choose between leasing an expensive, fixed high-bandwidth pipe which sits underutilized much of the time or forgoing the greater bandwidth.

Customers realize savings as multiple, stand-alone services (e.g. local voice, frame relay, Internet traffic, ATM, and long distance voice) are moved from separate, inefficient access facilities to a single, more efficient, integrated access facility. The integrated facility also will facilitate increased functionality and flexibility for communications between locations served by Sprint ION.

In telecommunications, the value of the increased functions and features at the originating end of the transmission is, of course, constrained by the capabilities at the terminating end. The full functionality of ION will be available to ION subscribers only. For example, video conferencing and other broadband applications between and among households will be possible if those households are Sprint ION subscribers. In the private line example, the off-net location would restrict the transmission to a subscribed maximum speed rather than higher speeds available on a managed bandwidth basis over the Sprint ION integrated access link.

Clearly, new products and services like Sprint ION are most beneficial if they are widely distributed and connected via a reliable network. For example, the first

fax machine had little value as a single machine. As more fax machines were purchased and utilized, the value of all fax machines increased. The same will be true of Sprint's ION network. The more customers utilizing a single broad band pipe to their premise and complete on-net Sprint ION traffic, the greater the value of the Sprint ION network to all users. Video telephony has little value if only a handful of people have the capability. However, much like the Internet, the value of the Sprint ION network is enhanced once many customers are networked together. Thus Sprint's ION envisions multiple ION Service Nodes and users all connected over a broadband network to provide new and innovative products and services through Sprint ION.

In addition, Sprint ION customers will realize savings over off-net calling prices as traffic is transported on-net. Sprint's costs for carrying traffic that only either originates or terminates on the Sprint ION platform are different from the costs that Sprint incurs for Sprint ION on-net traffic where both the origination and termination point subscribe to Sprint ION service. Sprint confronts different and lower costs for carrying on-net calls than carrying off-net calls. For on-net calls, Sprint can carry the entire call between customer premises without needing to translate the transmission from or to the traditional circuit-switched platform. For switched voice services (traditional long distance) involving off-net facilities, Sprint will incur additional costs to perform the necessary translation from ATM protocol at a Sprint Service Node before receiving/delivering the call from or to an off-net, circuit-switched environment. Of course, these calls involving off-net transactions also incur per minute access charges that are assessed by the incumbent local exchange carriers. Thus, for traffic that either originates or terminates to locations that are not served by Sprint ION, additional costs

are incurred above those required to carry a call connected via Sprint ION at both ends. Sprint plans to recover these higher costs through applying traditional Sprint product pricing, or some form of higher pricing that reflects the difference in costs, for service to off-net locations.

When both ends of a call are on-net, all of the cost benefits described above are realized. The greater the penetration of Sprint ION in the marketplace, whether within multiple locations of a single customer, or across diverse customers, the greater the savings that a Sprint ION customer may achieve. If Sprint ION does not reach some level of critical mass by being available across the nation to a large portion of a customer's locations or if only a small portion of a customer's call complete on-net, there may not be sufficient savings related to Sprint ION to justify movement from the status quo.

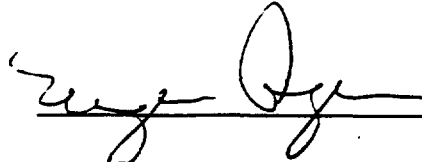
Market realities and the cost profile of Sprint ION to the customer lead to the conclusion that a customer that can maximize its on-net Sprint ION traffic is most attracted to Sprint ION service. This means that the unavailability of Sprint ION service in one region of the country has a chilling impact upon the ability of Sprint to market Sprint ION service in other areas of the country because it is more difficult for the customer to achieve the benefits promised from Sprint ION on-net transactions. Without these cost savings and increased functionality generated through contacts with other locations that can receive Sprint ION traffic on-net, many customers will choose to remain with their current service configuration because of customer inertia – a customer without a compelling reason to change carriers or services will not do so.

VIII Conclusion

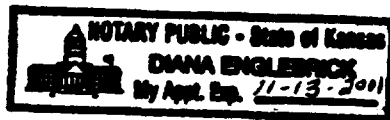
Many of the costs of firms providing voice and data telephony are largely fixed or sunk costs that are independent of the size of the firm providing the service. As the scale and scope of the firm increases, the sunk or fixed costs become a smaller portion of the total costs of the firm. Sprint will have to incur such fixed and semi-fixed costs to offer its new Sprint ION service customers. Other carriers also will have to incur such costs in order to develop and offer new local or combined local and long distance services.

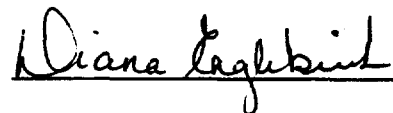
The value of the Sprint ION service to customers increases as the number of customers and geographic scope of Sprint ION service increases. Customer savings and the value to customers of Sprint ION service are maximized as more Sprint ION customers come on-net. The lack of availability of Sprint ION in a region will cause significant harm to the Sprint ION value proposition and harm the value of Sprint ION to customers.

I hereby swear, under penalty of perjury, that the foregoing is true and correct, to the best of my knowledge and belief.


Gene Agee

Subscribed and sworn before me this 12th day of October, 1998.




Notary Public

My commission expires:


RECEIVED
NOV 23 1998
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

**BEFORE THE
COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)
)
GTE CORPORATION,)
)
Transferor,)
)
and) CC Dkt. 98-184
)
BELL ATLANTIC CORPORATION,)
)
Transferee,)
)
For Consent to Transfer of Control)

AFFIDAVIT OF STEVEN SIGNOFF

I hereby swear, under penalty of perjury, that I have personal knowledge of the statements and allegations of facts contained in the attached affidavit, originally filed in CC Dkt. No. 98-141, and that it is true and correct, to the best of my knowledge and belief.


Steven Signoff

Subscribed and sworn before me this 18th day of November, 1998.

BETTY J. SOUTHARD
Notary Public - State of Kansas
My Appt. Exp. 5/29/99

Betty J. Southard
Notary Public

RECEIVED

NOV 23 1998

**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In re of Applications of)
)
AMERITECH CORP.,)
Transferor,)
)
and)
)
SBC COMMUNICATIONS, INC.,)
Transferee)
)
for Consent to Transfer Control)
of Corporations Holding Commission)
Licenses and Authorizations)
Pursuant to Sections 214 and 310(d))
of the Communications Act and)
Parts 5, 22, 24, 25, 63, 90,)
95 and 101 of the Commission's)
Rules)

CC Docket No. 98-141

AFFIDAVIT OF STEVEN SIGNOFF

1. My name is Steven Signoff. I am Vice President of Strategic Business Development for the Sprint Business unit of the long distance division of Sprint. I began my professional career at Sprint in 1989 in the finance organization. Since then, I have served as executive assistant to the president of the National Markets Group and the president of the Small and Medium Business Marketing Group. Other positions have included director level assignments to lead Sprint Quality efforts and Strategic Planning. In 1996, I served as an executive on assignment to France Telecom in Paris, France for eighteen months. I returned to the United States in June of 1998 and was

appointed Vice President of Strategic Business Development, leading the functions of strategic planning, business development, global alliance management, business transformation, program management, market research and competitive analysis.

2. I have been asked to provide this affidavit in connection with Sprint's participation in the FCC's proceeding to review SBC's proposed acquisition of Ameritech. More specifically, I have been asked to evaluate the claim made in the Application that the merger is necessary for SBC and Ameritech to provide local services outside their regions, particularly through the proposed "National-local" strategy. I have reviewed both the public interest section of the Application and an affidavit submitted by James Kahan. SBC and Ameritech argue that the merger is necessary to allow them first to accumulate 20 in-region incumbent markets and then launch service in 30 other domestic markets (as well a number of foreign markets) all in an effort to 'follow the [in-region] customer.' The outcome of not doing this, they claim, is to risk losing their in-region customers to competition.

3. I address and respond to a number of assertions and assumptions in this "National-Local-Global" strategy. The strategy assumes that SBC and Ameritech must 'follow the customer.' The Application states that the parties believe that they must position themselves to serve at least 70%- 80% of the telecommunications requirements of the largest customers. This is characterized as one of their "most fundamental assumptions." Kahan at ¶ 48. While no specific basis for the 70-80% figure is

given or explained, the Application assumes that the largest users want sole source supply arrangements: "Customers now see an opportunity to obtain what they want -- the option of having one principal source of service, one source of contact and consolidated lines across the nation and across the world". Kahan Aff. at page 10, also page 12. Another fundamental assertion is that SBC and Ameritech cannot adequately enter out-of-region markets unless they have a secured customer base in each local market they enter: "In the absence of the merger, SBC does not believe these strategies are viable and does not contemplate out-of-region entry into local exchange markets." Kahan Aff. at p.31.

4. As described in greater detail below, these assertions bear little resemblance to Sprint's marketing experience. Large users frequently and quite deliberately divide their telecommunications requirements among different providers, and so there is no particular reason to believe that only those suppliers geographically positioned to serve a set percentage of any one customer's needs will be considered. Also, competitive entry into local markets will most often require marketing to target customers without any pre-existing relationships. Because the largest purchasers of telecommunications services are sophisticated purchasers, and because SBC and Ameritech each are independently recognized by this group of customers as established, experienced providers of telecommunications services, I believe Mr. Kahan has placed too much emphasis on prior business relationships and brand recognition in this

context. I discuss these issues in more detail below.

5. It may be helpful to begin by recognizing that the National-local strategy comprises competition in three distinct marketplaces: long distance , in-region local services, and out-of-region local services. I assume here that interLATA authority has been granted, since otherwise this strategy appears to make no sense at all. As a businessman, I believe these markets present very different sorts of challenges, particularly for local monopolists such as SBC and Ameritech. The long distance market is very competitive, especially so in the market for the largest users. Local markets, on the other hand, each are dominated by a monopoly provider only just beginning to see a very small and fragile amount of competition. Here, the incumbent advantages are substantial, especially until the rules for opening these markets are fully set and implemented.

6. I have set forth this set of differences because it seems to me that the strategy described in the Application seems to confuse them. For example, the need for national coverage is one I would agree with for the provision of long distance services to large users, but it is merely a wish in the context of local services, given the very limited opportunities for competition here. Also, the description of out-of-region local entry does not appear to account for the competitive problems that exist in these markets. I think it is important to consider these very different stages of competition in any discussion of a strategy to package them all together.

Follow the Customer

7. The strategy described in the Application is contingent upon two assumptions. First, it assumes that the successful deployment of the strategy requires that a very large number of large business customers are headquartered in, and can be "followed" from, SBC's service territories. Second, it assumes that, in order to sell services to these customers, a supplier must serve everywhere (or almost everywhere) the customers' operations are located. As an initial matter, I would note that if SBC and Ameritech were correct that in fact the largest customers demand sole source supply, then 70-80% coverage wouldn't suffice; only 100% coverage would meet the stated requirement. Of course, not even the pre-divestiture Bell System had this coverage.

8. The Application insists that SBC or Ameritech will be at risk of losing their existing, in-region local customer base simply because they could not 'follow the customer' for all purposes in all locations. There are two key assumption here. First, Kahan assumes that SBC's competitors *will be able* to offer 100% coverage, and so SBC must position itself to match them. Secondly, he assumes that large buyers *will want* to purchase all of their telecommunications requirements from one source. The problems with these assumptions are explained below.

9. Suppliers will generally not be able to offer sole

source arrangements for the largest users for some time to come, at least not where local services across several geographic regions are needed. Given the limited amount of local competition that has developed to date, it will be a long time before anyone will be so situated. In Sprint's experience, the RBOCs, including SBC and Ameritech, have vigorously resisted cooperating in the effort to lower barriers to entry into local markets. I have no reason to believe that this resistance will subside to any material degree in the near future. While it is true that legal changes should make it eventually easier for one company to offer local services in more and more markets, this has not yet occurred and is unlikely to occur for some time.

10. Thus, while partnering is described in Mr. Kahan's testimony as a poor alternate, it is Sprint's experience that multiple sourcing is necessary and will remain so for a long time until competitive local services are more readily available.

11. As discussed, Mr. Kahan's need to 'follow the customer' also assumes that most or all large users desire single source supply arrangements. This is not Sprint's experience, even if one were to consider only long distance services contracts. Many large buyers deliberately do not purchase all their telecommunications needs from a single source. In Sprint's experience, large users often divide up their requirements in numerous ways, e.g., purchasing voice and data lines from distinct providers, splitting their requirements among competing providers by volume or by geography, purchasing services primarily from one carrier and using another as redundant or

backup source, etc.

12. Buying patterns also vary with the locus of decisionmaking for these users, and these too can vary widely. While one would expect to see some centralization of the decisionmaking, the degree of centralization can vary materially. A large multinational business with multiple subsidiaries across the country and abroad may purchase its telecommunications needs by groups of subsidiaries in accordance with its corporate organization, by region of the country, national versus foreign, etc. Some of these differences are due to variations in the telecommunications needs of specific companies. Where local communications with the public is a priority, such as with retail businesses, localized (or decentralized) decisionmaking may be more common. In contrast, where the greatest telecommunications needs are internal to the company between and among a number of geographic areas, more centralized decisionmaking may occur. Other differences can be due to managerial preferences and such other factors independent of the underlying telecommunications needs. The point is that no one pattern captures the majority of cases.

13. Just by way of example, Sprint is one of a number of suppliers to a Fortune 100 multinational conglomerate whose corporate policies expressly prescribe the use of multiple vendors for purposes of redundancy and price leverage in negotiations. Another example is Sprint's wholesale contract to supply a large telecommunications company for only voice purposes; the same buyer has separately purchased its data transmission

requirements. Of course, the most public example is the federal government's procurement of telecommunications services, which is also divided among multiple carriers.

14. Of course, some buyers do want sole source contracts. But in our experience, no one particular pattern fairly characterizes these largest users as a group.

15. I would note my agreement with Mr. Kahan in his general observation that the legal changes of the past several years can and likely will lead to changes in the marketplace. Mr. Kahan is of course correct that, over the time period in which local telecommunications services were provided on a legal monopoly basis, buyers had no choice but to purchase local services in different regions from distinct local monopoly vendors. Once local markets are actually opened up to competition, carriers will be in a position to sell more services to customers. I disagree, however, with Mr. Kahan's assumption that where we are inevitably headed is a market where all buyers purchase all their needs exclusively from one vendor. Although local service is no longer provided as a legal monopoly, its provision has not thus far been integrated to any great extent with the provision of long distance service.

16. Nevertheless, I agree with Mr. Kahan that one-stop shopping will in the future become more important to customers. My view is that such a trend is likely because it is most efficient from an engineering standpoint to provide all services - voice and data, local and long distance - over a single packet-switched, broadband network. This is the reason for the

introduction of Sprint ION service. To my knowledge, neither SBC nor Ameritech has a similar vision of the future, however. Both apparently intend to continue to provide voice service, as they traditionally have, over circuit switched networks, and to separate the provision of data service onto packet switches. If voice and data continue to be provided separately, there would appear no overriding reason for buyers to utilize a single vendor. On the contrary, under such circumstances, the ever-increasing importance of data may lead to an increase in buyers driven by quality consideration for this set of services, leaving their voice requirements to other suppliers. In fact, Mr. Kahan's affidavit sets data (IP) apart from other telecommunications services, notwithstanding his emphasis on the importance of serving all customers with all services.

17. The 'follow the customer' assertion also assumes that large users are heavily influenced by existing business relationships. While the existence of standing business relationships can be helpful in obtaining additional business from a customer, it is not sufficient by itself and is far behind other factors in terms of importance, especially for large users who are sophisticated purchasers of telecommunications services. This is especially true where the large user is setting out to contract for some substantial set of telecommunications needs (such as when an existing contract is near expiration), as compared with a buyer looking only to add incrementally to its existing services already under contract.

18. The telecommunications services industry is made up of

many companies. Among the hundreds (if not thousands) of competitors, there is a smaller group of well-established firms with recognized expertise and experience in this field. These firms are in some cases household names, as with the major long distance carriers. SBC and Ameritech seem to assume that they enjoy this recognition only in-region, but among large telecommunications users, that employ full time telecommunications managers, their names are known throughout the country and globally. Thus, the value of brand recognition, described as a hurdle in the application, is one already achieved by SBC and Ameritech.

19. It is helpful to consider in this context how large business users make their telecommunications purchasing decision when they have competitive alternatives to consider. Large users purchase telecommunications based on a variety of factors. The two factors that are unequivocally most important are price and quality. The managers responsible for their companies' telecommunications needs are typically under substantial pressures to obtain the best services at the lowest cost. Thus, in a typical procurement effort, large users will not merely extend existing service arrangements but will open up the contract opportunity to the industry at large. Again, while managers may be reluctant to put too much of their business at risk with 'newcomer' suppliers, SBC and Ameritech are recognized and established suppliers and would not be considered risky choices on the basis of name recognition.

20. The follow the customer strategy places heavy emphasis

on existing in-region relationships. It is not clear to me exactly what is meant by this. If all SBC and Ameritech are saying by this is that, as the incumbent monopoly, they have substantial advantages in securing additional business from their customers, no one could really disagree with that statement. To the extent they believe that they will win all of a customer's business simply because they serve that customer in-region, more specifically, because that customer's headquarters is located in-region, I disagree. If nothing else, they will have to compete out-of-region for business now held by another monopoly incumbent.

21. It is important to consider the logical conclusion of the assertion that carriers will enjoy overwhelming advantages in gaining the business of large customers headquartered in their region. It would require the conclusion that carriers would not really compete for the large users but rather "divide" them based on the location of their headquarters. Moreover, if one accepts the story, it would mean that a carrier that lacks an in-region monopoly base to work from could not survive in this market environment for services to large users.

22. SBC and Ameritech seem to be arguing that they need to merge not so much in order to compete but rather to expand the size of their incumbent base so they can better leverage their monopoly outside the bounds of their current area. Thus, their story predicts a decrease in competition -- in both local and long distance services -- as customers are divided up based on the location of their headquarters. Note also, then, their story

would seem to require the conclusion that SBC and Ameritech are likely to lose the business of those large users which have branch operations in their regions but are headquartered in another region, something I doubt that either company would want to concede.

23. The underlying assumption that this will simply be a battle of a few giants is something else I question. The history of telecommunications shows that size and reputation alone won't guarantee market success. We have witnessed the success of new entrants into both local and long distance services; many of these firms were initially start-up companies. While of course buyers may seek assurances of quality and reliability in dealing with new suppliers (as well as with experienced providers), some large sophisticated purchasers are willing to take risks and may test new entrants with at least some portion of their business and expand the relationship if they're satisfied.. If this were not the case, then we would not be witnessing the tremendous growth for resellers and smaller facilities-based firms.

24. The Application provides a rather complicated set of figures to explain why the merged entity would have to reach 50 markets to succeed. It suggests a detailed analysis has been undertaken of the telecommunications requirements (by volume and location) of each Fortune 500 company headquartered in either SBC's or Ameritech's region. It is really not possible to comment on these assertions without additional information as to how these numbers were derived. Sprint is not aware of any specific, publicly available data source that would accurately

and comprehensively report this sort of data. Without the underlying basis for the assertion, however, there is no particular reason to think that any particular number of markets must be entered simultaneously for the National-local strategy to succeed.

25. Further, it is not at all clear how one can accurately divide telecommunications requirements across geographic markets without specific customer information. Certainly some assumptions would have to be made about the percentage of dollars spent on local versus toll services, and on voice versus data services. These patterns could vary considerably across the Fortune 500 companies. Because the 70-80% figure is so crucial to the stated need to enter 50 markets, its underlying rationale should be examined carefully. And because the means by which the conclusion that 50 markets must be reached is also hidden, that too should be subject to rigorous scrutiny.

Global presence

26. The Application also claims that the merger is necessary to this strategy because it will allow for the combination of the international assets of the two firms. But the merger would not materially improve either firm's international presence given the secondary nature of most of the markets in which each holds interests. For example, such major areas of international commerce as Japan, Germany and Brazil are missing from the even the combined foreign assets. The new combined firm would have to enter these locations on its own or,

far more likely will have to partner in order to serve customers with coverage of the major foreign markets.

Secured entry

27. Mr. Kahan states that it would not be prudent for either SBC or Ameritech to enter out-of-region markets alone because neither company alone would have sufficient base of secured business flowing from in-region customers. This too is inconsistent with Sprint's experience. It is in fact rare in local telecommunications services that serving the customer in one locale is a necessary prerequisite to obtaining that customer's business in another location. Obviously existing customer relationships may help, but they are not essential. As I have discussed above, SBC's name would be widely recognized in Ameritech's region (and elsewhere) among the large telecommunications users.

28. Mr. Kahan does not specify what advantages they seek to gain from this broader customer base; if he is describing an ability to exploit incumbent advantages, then all he is saying is that they want a larger monopoly base from which to capture additional service requirements. But it is my understanding that at least some of the more apparent leverage opportunities may be foreclosed by law. For example, it may be helpful to market to a potential customer if one has available proprietary information about the customer's telecommunications usage, but I understand the new law and FCC regulations substantially inhibit SBC or Ameritech from sharing this information with their competitive

affiliates.

29. It is in fact the unusual case that a telecommunications supplier can enter a new geographic area through an existing customer base. Competition will require each new entrant to prove itself in the new marketplace. Again, the success to date of new entrants that target only certain geographic areas of the country proves the assumption wrong.

30. There are of course scale economies in providing local telecommunications services in a particular market. However, the minimum scale required has been substantially reduced from earlier days, due to a variety of factors. In part, this is due to the availability of and reduced costs of smaller sized switches as well as regulatory requirements allowing for resale or leasing of unbundled elements (where the incumbent has made these meaningful opportunities). As I understand it, the purpose of the 1996 Act's requirements for resale and unbundled network elements access was precisely to allow for graduated entry into local markets.

31. In sum, a number of assertions and assumptions underlying the 30 market strategy are contrary to market experience.

I hereby swear, under penalty of perjury, that the foregoing is true and correct to the best of my knowledge and belief.



Steven Signoff

Subscribed and sworn before me this 12th day of October,

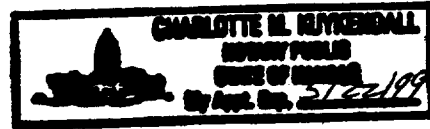
1998.

Charlotte M. Kuykendall

Notary Public

My Commission expires:

5/22/99



Bell Atlantic and GTE Appeals
Under the Telecommunications Act of 1996

Bell Atlantic

Circuit Court Appeals of FCC Orders

Bell Atl. Tel. Cos. v. FCC, 131 F.3d 1044 (D.C. Cir. 1997) (provision of interLATA services under Section 272(e)(4)).

U S W. v. FCC, Case No. 97-9518 (10th Cir.) (number portability appeal).

Texas Office of Pub. Util. Counsel v. FCC, Case No. 97-60421 (5th Cir.) (universal service appeal).

SBC Communications, Inc. v. FCC, 138 F.3d 410 (D.C. Cir. 1998) (Section 271 Oklahoma appeal).

BellSouth Corporation, et al. v. FCC, Case No. 98-1087 (D.C. Cir.) (Section 271 Louisiana appeal) (case since dismissed pursuant to BellSouth stipulation).

USTA v. FCC, Case No. 97-1469 (D.C. Cir.) (price caps appeal).

Southwestern Bell v. FCC, Case No. 97-2618 (8th Cir.) (access charges appeal).

Southwestern Bell v. FCC, Case Nos. 97-3389, 97-3576, 97-3663, 97-4106, 1998 U.S. Dist. LEXIS 18352 (8th Cir. Aug. 10, 1998) (appeal of third order on reconsideration of common/shared transport).

Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), cert. granted, 118 S. Ct. 879 (1998) (local competition/interconnection order appeal).

District Court Appeals

MCI v. Bell Atl., No. 97-3076 (D.D.C.).

Bell Atl.-Del. v. McMahon, AT&T, No. 1:97cv00312 (D. Del.) (appeal of SGAT).

Bell Atl.-Del. v. Delaware Pub. Serv. Comm'n, AT&T, No. 1:97cv00511 (D. Del.).

MCI v. Bell Atl., No. 2:98cv00109 (D.N.J.).

MCI v. Bell Atl.-Pa., No. 1:CV-97-1857 (M.D. Pa.).

AT&T, GTE v. City of Dallas, Case No. 3:98-CV-0003, 1998 U.S. Dist. LEXIS 8932 (N.D. Tex. June 8, 1998) (preemption of municipal ordinance).

GTE v. Wood, MCI, No. M-97-078 (S.D. Tex.).

GTE v. Wood, Sprint, ACSI, No. M-97-115 (S.D. Tex.).

GTE v. Wood, AT&T, No. M-97-138 (S.D. Tex.).

GTE v. Morrison, AT&T, Cox Fibernet, MCI, Case No. 3:97CV493, 1998 U.S. Dist. LEXIS 7881 (E.D. Va. May 19, 1998).

Sprint v. GTE, No. C97-699 (W.D. Wash.).

MCI v. GTE, Nos. C97-742, C97-905, C97-928, 1998 U.S. Dist. LEXIS 11335 (W.D. Wash. July 7, 1998).

GTE v. Washington Utils. & Transp. Comm'n, AT&T, No. C98-491 (W.D. Wash.).